Supreme Court, U. S.

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No. 74-121

In the

Supreme Court of the United States

OCTOBER TERM 1973

In The Matter Of CHICAGOLAND IDEEL CLEANERS, INC., Bankrupt

CRAIG PHELPS, Receiver In Bankruptcy,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE SEVENTH CIRCUIT

KEVIN J. GILLOGLY
One North LaSalle Street
Suite 865
Chicago, Illinois 60602
Attorney for Petitioner

Of Counsel:
DANIEL C. AHERN
DENNIS E. QUAID

The Scheffer Press, Inc.—(312) 263-6850

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SUPREME COURT OF THE UNITED STATES

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No.

In The Matter Of CHICAGOLAND IDEEL CLEANERS, INC., Bankrupt

CRAIG PHELPS, Receiver In Bankruptcy,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION OF CRAIG PHELPS, RECEIVER, FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Craig Phelps, Receiver of Chicagoland Ideel Cleaners, Inc., Bankrupt, petitions this Honorable Court for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

Your Petitioner seeks review of the judgment of the Court of Appeals, dated May 7, 1974, ... F.2d ..... (7th Cir., 1974), reversing the United States District Court for the Northern District of Illinois, Eastern Division, Lynch, J., (not reported), which affirmed the ruling of the Referee in Bankruptcy (now Bankruptcy Judge) (not reported) ordering Nathan Yorke, as assignee for

the benefit of creditors, to turn over to said Receiver the proceeds of the sale of the bankrupt's assets which the assignee conducted prior to the institution of the present bankruptcy proceedings.

STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on May 7, 1974, and mandate was returned to the District Court on July 15, 1974. A Petition for Rehearing by the Court of Appeals was filed on May 20, 1974, and denied by order dated May 24, 1974.

Jurisdiction to review the judgment of the Court of Appeals is conferred upon this Court by the Bankruptcy Act, Section 24c (11 U.S.C. §47c) and 28 U.S.C. §1254(1).

QUESTIONS FOR REVIEW

First: Whether the Court of Appeals incorrectly granted to the United States a priority based upon the Internal Revenue Code of 1954 for taxes in violation of and contrary to the priorities for payment of claims established by the Bankruptcy Act?

Second: Whether the Court of Appeals incorrectly held that service of a Notice of Levy upon an assignee for the benefit of creditors subsequent to the assignment reduced the bankrupt's property then held by the assignee to the constructive possession of the United States?

Third: Whether the Court of Appeals incorrectly determined that the Bankruptcy Court lacked summary jurisdiction to adjudicate the controversy before it without the consent of the United States?

Fourth: Whether the Court of Appeals incorrectly transferred the burden of proof to the Petitioner to present evidence of the non-existence of assessment and demand upon the bankrupt for payment of the claimed taxes when the United States relied upon the existence of assessment and demand and had knowledge of such facts?

STATUTES INVOLVED

The statutory provisions involved in this case are Sections 2((21) (11 U.S.C. 11a(21)); 64 (11 U.S.C. 104); 67 (11 U.S.C. 107); and 70 (11 U.S.C. 110) of the Bankruptcy Act and Sections 6321, 6331 and 6672 of the Internal Revenue Code of 1954 (26 U.S.C.), all of which are set forth in Appendix D.

STATEMENT OF THE CASE

The bankrupt, Chicagoland Ideel Cleaners, Inc., is an Illinois corporation with its principal place of business in Chicago, Illinois. On June 28, 1971, the directors of the bankrupt corporation executed written consents to a general assignment of its assets for the benefit of creditors and on that date the bankrupt did assign and transfer all of its assets to Nathan Yorke, as assignee for the benefit of creditors. The assignee liquidated the assets of the bankrupt and thereafter, on August 25, 1971, the Internal Revenue Service filed a Notice of Tax Lien with the Recorder of Deeds for the County of Cook, claiming a lien on the property of Chicagoland Ideel Cleaners, Inc., based upon purported assessments of March 12, May 5, May 28 and June 4, 1971, allegedly after demand, in the amount of $140,831.59. On the same date, the Internal Revenue Service effected a Notice

of Levy upon Nathan Yorke, the assignee, without any further effort to reduce the proceeds to its possession.

An involuntary petition in bankruptcy was filed on September 14, 1971 against Chicagoland Ideel Cleaners, Inc., and Craig Phelps was appointed as Receiver on September 24, 1971. Chicagoland Ideel Cleaners, Inc., was adjudged a bankrupt on September 28, 1971.

On October 19, 1971, the Receiver filed an application requesting an order compelling the assignee to surrender and turn over to the Receiver the proceeds of sale in his possession. By way of intervention, the United States answered the Receiver's application against the assignee by asserting that the Bankruptcy Court lacked jurisdiction over the United States and also lacked summary jurisdiction because the United States was entitled to possession of the monies held by the assignee. On December 9, 1971, the Referee in Bankruptcy ordered the assignee to turn over these proceeds to the Receiver. The United States filed a Petition for Review on December 16, 1971. The Referee's order was approved by the United States District Court for the Northern District of Illinois, Eastern Division, on January 11, 1972, whereupon the United States moved to vacate the District Court's order on January 21, 1972. The motion to vacate was denied on March 2, 1972.

A Notice of Appeal to the United States Court of Appeals for the Seventh Circuit was filed on April 28, 1972, on behalf of the United States. The Court of Appeals, on May 7, 1974, reversed the January 11, 1972 order of the District Court approving the decision of the Referee in Bankruptcy. The Receiver filed a Petition for Rehearing which was denied on May 24, 1974. The Receiver respectfully petitions this Court for a Writ of Certiorari to review the judgment of the Court of Appeals.

REASONS FOR GRANTING THE WRIT

The Court of Appeals erroneously decided that the United States gained constructive possession over funds in the hands of an assignee for the benefit of creditors, thereby defeating the summary jurisdiction of the Bankruptcy Court. In doing so, the Court acknowledged that its decision was in conflict with that of the Ninth Circuit, in *In Re United General Wood Products Corporation,* 483 F.2d 975 (9th Cir., 1973). In addition to creating a conflict between Circuits and introducing a degree of uncertainty into this area of law, the decision of the Court also serves to frustrate the policy of the Bankruptcy Act by granting unwarranted priorities for taxes due the United States based upon the Internal Revenue Code which are in conflict with those priorities created by the applicable statutory provision, the Bankruptcy Act.

Section 64 of the Bankruptcy Act, 11 U.S.C. 104, establishes priorities for the payment of creditors. Taxes due to the United States enjoy a fourth priority, following costs of administration, wage claims and certain expenses of a creditor in defeating an arrangement or wage-earner plan. By finding that the Internal Revenue Service constructively possessed the assets held by the assignee for the benefit of creditors, the Court of Appeals upset the system of priorities by holding that the Internal Revenue Service was entitled to a lien pursuant to the Internal Revenue Code of 1954, 26 U.S.C. 6321.

A similar claim was asserted by the United States and rejected in the decision of *In Re United General Wood Products Corporation, supra.* The Ninth Circuit held that constructive possession of the property remained in the bankrupt despite service of a Notice of Levy upon a

factor, relying on *Taubel-Scott-Kitzmiller Co.* v. *Fox,* 264 U.S. 426 (1924), and rejected the argument that a Notice of Levy pursuant to Section 6331 of the Internal Revenue Code, 26 U.S.C. 6331, reduced the property to the possession of the United States. The Ninth Circuit heeded the admonishment of this Honorable Court in *United States* v. *Randall,* 401 U.S. 513 (1971) that the Bankruptcy Act "is an overriding statement of federal policy on this question of priorities" (401 U.S. at 516). The Seventh Circuit failed to follow *United States* v. *Randall, supra,* or the strong policy of the Bankruptcy Act.

The original question before the Bankruptcy Court was whether it possessed jurisdiction to proceed to adjudicate the controversy in a summary manner. In order to resolve the jurisdictional question, the Bankruptcy Court was therefore empowered to decide whether the Court had actual or constructive possession of the property. *Taubel-Scott-Kitzmiller Co.* v. *Fox, supra.* Justice Brandeis held in that decision that the Bankruptcy Court has constructive possession of property not in the possession of the bankrupt where "the property is held by some other person who makes no claim to it; . . ." (264 U.S. at 432-3). In the case at bar, the assigned property was liquidated by the assignee who has never made any claim to the funds in question and did not answer the Receiver's application.

The United States asserts that its Notice of Levy served upon the assignee subsequent to the assignment but prior to the initiation of bankruptcy proceedings entitled it to constructive possession of the property. However, the lien of the United States attaches only to the property belonging to the taxpayer, and the extent of those rights are to be measured by state law. *City of New York*

v. *United States,* 283 F.2d 829 (2nd Cir., 1960). Under Illinois law, a general assignment for the benefit of creditors transfers absolute title to the assignee in his official capacity, as was true in *City of New York. Wilson* v. *Pearson,* 20 Ill. 81 (1858); *Myers* v. *Kinzie,* 26 Ill. 36 (1861); *Weber* v. *Mick,* 131 Ill. 520, 23 N.E. 646 (1890); and *Browne-Chapin Lumber Co.* v. *Union National Bank,* 159 Ill. 458, 42 N.E. 967 (1896). Consequently, when the Notice of Levy was served, there no longer existed any interest of the taxpayer upon which the lien could attach and possession either actual or constructive of the proceeds in the hands of the assignee did not pass to the United States. Upon filing of the Bankruptcy Petition, possession came to the Bankruptcy Court, and in that manner, supported the exercise of summary jurisdiction.

In addition to the above basis for the Bankruptcy Court's exercise of summary jurisdiction, specific provisions of the Bankruptcy Act authorized such proceedings. Section 2a(21), 11 U.S.C. 11a(21), creates Courts of Bankruptcy invested with jurisdiction to require an assignee for the benefit of creditors to deliver the property in his possession or control to the Receiver or Trustee appointed by the Bankruptcy Court. The jurisdiction conferred by this section is summary in nature. *May* v. *Henderson,* 268 U.S. 111 (1925); *In Re John M. Russell,* 318 U.S. 515 (1943); and Collier, *Bankruptcy,* Vol. 1, Par. 2.78 (14 Ed.). As an intervening party, the United States is bound by the proceedings as they exist and should not be permitted to alter their nature. Section 70a(8), 11 U.S.C. 110a(8), is a second provision providing for the exercise of summary jurisdiction over property held by an assignee for the benefit of creditors. These two provisions further demonstrate the fact that Congress intended disputes involving property held

by an assignee to be resolved summarily in order to aid the administration of the bankruptcy estate.

Section 67c, 11 U.S.C. 107c, specifically involves tax liens, their validity and priority. Subdivision (3) of the section provides that tax liens on personal property not accompanied by possession shall be postponed to payment of costs of administration and wage claims, in effect, thus giving such tax liens a third rather than a fourth priority. The effect of the Court of Appeals' decision is to erroneously grant to the United States a first priority before costs of administration and wage claimants. The clear policy of the Bankruptcy Act has been to subordinate tax claims to the allowance of costs of administration. *Guarantee Title & Trust Co.* v. *Title Guaranty & Surety Co.*, 224 U.S. 152; *Davis* v. *Pringle*, 268 U.S. 315; and *United States* v. *Randall, supra.* Paragraph c of Section 67 was added to the Act to further this policy when liens for taxes were involved. Subdivision c(3) thereof was intended to protect the existing set of priorities from non-possessory tax liens. 1966 U.S. Code Cong. and Admin. News, p. 2462. Congress has determined that those individuals whose efforts have benefited the administration of the affairs of the bankrupt and the accumulation of an estate available for distribution should not have labored without hope of compensation. More importantly, wage claimants are also sought to be protected in their second class priority by Section 67c(3). Perhaps more than anyone else, wage claimants are particularly dependent upon the recovery of their claims in order to provide for the necessities of life. The effect of the ruling of the Court of Appeals will be to deprive these individuals of any recovery, contrary to the policy considerations established by Congress. *Id.* If the wage claimants are to be paid, their

right to priority of payment must be preserved by this Court. This is their only chance of recovery, whereas the United States has a third priority plus its right to assert the personal liability of the officers of the bankrupt corporation for payment, as contained within Section 6672 of the Internal Revenue Code of 1954, 26 U.S.C. 6672. Congress has adequately provided for the protection of the respective rights of all parties involved through the provisions of the Bankruptcy Act and the Internal Revenue Code. If an apparent conflict arises between the two statutory measures involving priority of payment, the act dealing more specifically with the subject should control. The Bankruptcy Act is that measure wherein Congress carefully weighed the rights of the different parties and established a system of priorities. That system should not be upset through the means of the tenuous theory of the United States which has been rejected by the Ninth Circuit.

No competent evidence of the assessments or demand within sixty days thereafter was presented. The Court of Appeals accepted the printed recitations contained within the Notice of Tax Lien and Notice of Levy that assessment and demand had been made and cast the burden upon the Petitioner to show otherwise. The United States relied upon the existence of assessment and demand for the basis of its claim of a lien and is the party having knowledge of whether these procedures were properly taken. It was incumbent upon the United States to go forward and present evidence on this issue and this they failed to do. The Receiver did not have access to such information, did not rely upon it and could not present evidence of a negative. The Court of Appeals erred in accepting this fact as being established by the record.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

KEVIN J. GILLOGLY
One North LaSalle Street
Suite 865
Chicago, Illinois 60602
Attorney for Petitioner

Of Counsel:
DANIEL C. AHERN
DENNIS E. QUAID

APPENDIX A

In The
UNITED STATES COURT OF APPEALS
For The Seventh Circuit

SEPTEMBER TERM, 1973 — JANUARY SESSION, 1974

No. 72-1620
In the Matter of Chicagoland Ideel Cleaners, Inc., Bankrupt
United States Of America,
Appellant,
v.
Craig Phelps, Receiver in Bankruptcy,
Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 71 B 5396
WILLIAM J. LYNCH, *Judge.*

HEARD FEBRUARY 13, 1974 — DECIDED MAY 7, 1974

Before HASTINGS, *Senior Circuit Judge*, CUMMINGS and STEVENS, *Circuit Judges.*

CUMMINGS, *Circuit Judge.* Taxpayer, Chicagoland Ideel Cleaners, Inc., is an Illinois corporation with its principal place of business in Chicago. In March 12, May 21, May 28, and June 4, 1971, assessments were made against the taxpayer totaling $140,831.59 for withholding and federal unemployment taxes for periods from September 30, 1970, to March 31, 1971. On June 28, 1971, pursuant to the written consents of its directors, taxpayer assigned

and transferred all of its assets to Nathan Yorke as assignee for the benefit of its creditors. Thereafter Yorke proceeded to liquidate its assets. On August 25, 1971, the Internal Revenue Service filed in the office of the Recorder of Deeds of Cook County, Illinois, a notice of tax lien with respect to the taxes previously assessed and on the same date served a notice of levy on assignee Yorke. The notice of tax lien indicated that the $140,831.59 in taxes had been assessed against taxpayer and that after demand for payment, the taxes remained unpaid. The notice of levy stated that the taxpayer's properties "are hereby levied upon and seized for satisfaction" of the taxes.

On September 14, 1971, an involuntary petition for bankruptcy was filed in the court below, and a receiver was appointed ten days thereafter. The taxpayer was adjudged bankrupt on September 28, 1971.

Three weeks thereafter, the receiver filed an application for an order requiring assignee Yorke to turn over all of taxpayer's assets to the receiver. The Government urged that the bankruptcy court lacked summary jurisdiction to grant the application on the ground that possession of the property held by the assignee had been in the United States since August 25, 1971, when it filed its notice of tax lien and served its notice of levy upon assignee Yorke. However, on December 9, 1971, the referee in bankruptcy ruled that assignee Yorke held "inalienable title" to the taxpayer's assets and that the Internal Revenue Service's notice of levy was a "nullity." Therefore, he ordered the assignee to turn over to the receiver all of taxpayer's assets in the assignee's possession. After considering the Government's petition for review of the referee's order, the district court approved the order on January 11, 1972, and reaffirmed its approval on March 2, 1972. We reverse.

Here the four tax assessments against the taxpayer occurred in March, May and June 1971. The notice of tax lien and the notice of levy both recite that the taxes

remained unpaid after demand.[1] These notices are regular on their face. Where, as here, the receiver has not come forward with any evidence suggesting that demands were not made, we will accept the recitations in the notices. Therefore, by virtue of Sections 6321 and 6322 of the Internal Revenue Code,[2] the Government's liens arose and attached to taxpayer's property on the dates of assessment and demand. The liens were thereafter valid and perfected against all persons except purchasers, holders of security interests, mechanic's lienors or judgment lien creditors, and the liens became effective against those four classes when the notice of tax lien was filed on August 25, 1971, 26 U.S.C. § 6323(a). The receiver does not assert that assignee Yorke is in one of the four protected classes.

Under Treasury Regulation § 301.6331-1(a), "Levy may be made by serving a notice of levy * * *." This regulation does not go beyond the authority of the statute, which provides: "The term 'levy' as used in this title includes the power of distraint and seizure *by any means.*"

[1] The demands had to be made within 60 days of the assessments. 26 U.S.C. § 6303(a).

[2] Section 6321 provides:

> "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

Section 6322 provides:

> "Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time."

26 U.S.C. § 6331(b) (emphasis supplied). The regulation was implemented by the notice of levy served on assignee Yorke August 25, 1971, which advised him that taxpayer's properties "are hereby levied upon and seized • • •." Thus about three weeks prior to the filing of the bankruptcy petition the property levied upon was reduced to possession of the United States superior to that of the receiver. See *United States* v. *Pittman*, 449 F.2d 623, 627 (7th Cir. 1971); *Rosenblum* v. *United States*, 300 F.2d 843 (1st Cir. 1962); *United States* v. *Eiland*, 223 F.2d 118 (4th Cir. 1955); see also *Youngstown S. & T. Co.* v. *Patterson-E.-C. of Ind.*, 227 F.Supp. 208, 217 (N.D.Ind. 1963); *Consumers Power Co.* v. *Rubiner*, 225 F.Supp. 926, 929 (E.D. Mich. 1963); *United States* v. *Manufacturers National Bank*, 198 F.Supp. 157 (N.D.N.Y. 1961); *In re Venda Manufacturing, Inc.*, 60-2 U.S. Tax Cas., ¶ 9480 (S.D. Cal. 1960).

The receiver insists that actual possession is necessary to remove the Government's tax liens from the subordinate priority accorded them under Section 67c(3) of the Bankruptcy Act.[3] However, *Eiland* and *Rosenblum* are squarely

[3] Section 67c(3) provides:

"Every tax lien on personal property not accompanied by possession shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. Where such a tax lien is prior in right to liens indefeasible in bankruptcy, the court shall order payment from the proceeds derived from the sale of the personal property to which the tax lien attaches, less the actual cost of that sale, of an amount not in excess of the tax lien, to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. If the amount realized from the sale exceeds the total of such debts, after allowing for prior indefeasible liens and the cost of the sale, the excess up to the amount of the difference between the total paid to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and the amount of the tax lien, is to be paid to the holder of the tax lien." 11 U.S.C.A. § 107(c)(3) (1974 Supp.).

to the contrary with respect to intangibles (such as involved here) and we consider them persuasive. As Judges Parker and Woodbury there pointed out, contrary cases relied upon by the present taxpayer dealt either with tangible property or with different language contained in the Internal Revenue Code of 1939 or state tax laws. See *Givan* v. *Cripp*, 187 F.2d 225 (7th Cir. 1951); *United States* v. *Odell*, 160 F.2d 304 (6th Cir. 1947); *City of New York* v. *Hall*, 139 F.2d 935 (2d Cir. 1944); see also *Division of Labor Law Enforcement* v. *Goggin*, 165 F.2d 155 (9th Cir. 1947), reversed on other grounds, 336 U.S. 118. It is also significant that even *Givan* and *Odell* recognized that possession could be either actual or constructive. Those cases contemplated that the levy would be complete when the Government had served a warrant of distraint in addition to its notice of levy. We see no reason why the language necessary to create constructive possession may not be printed in full on one piece of paper. Historically, service of notice has been sufficient to seize a debt. *Miller* v. *United States*, 78 U.S. 268, 297. Finally, Judge Pell's careful discussion in *Pittman* demonstrates that under the Internal Revenue Code, levy is equivalent to seizure and gives the Government full legal rights in the property levied upon. 449 F.2d at 627.

Since possession of the property resided in the United States as against the receiver, the bankruptcy court lacked jurisdiction summarily to adjudicate the controversy without the Government's consent. *Cline* v. *Kaplan*, 323 U.S. 97, 99; *In re American National Trust*, 426 F.2d 1059, 1065 (7th Cir. 1970). The United States is now entitled to have its claim adjudicated in a plenary suit. We respectfully decline to follow the contrary holding in *In re United General Wood Products Corp.*, 483 F.2d 975 (9th Cir. 1973).

The district court's order approving the turnover order is reversed.

APPENDIX B

Opinion by Judge Cummings
UNITED STATES COURT OF APPEALS
For The Seventh Circuit
Chicago, Illinois 60604
May 7, 1974
Before
Hon. John S. Hastings, Senior Circuit Judge
Hon. Walter J. Cummings, Circuit Judge
Hon. John Paul Stevens, Circuit Judge

No. 72-1620

In the Matter of Chicagoland Ideel Cleaners, Inc., Bankrupt

United States Of America,
Appellant,

v.

Craig Phelps, Receiver in Bankruptcy,
Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the order approving the turnover order of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, in accordance with the opinion of this Court filed this day.

IT IS FURTHER ORDERED that costs be taxed in favor of the United States of America.

APPENDIX C

UNITED STATES DISTRICT COURT
Northern District of Illinois
Eastern Division
Name of Presiding Judge, Honorable William J. Lynch
Cause No. 71 B 5396 Date Jan. 11, 1972
Title of Cause
In The Matter of Chicagoland Ideel Cleaners, Inc.
Brief Statement of Motion
Petition for Review

ORDER: After careful review, the findings of fact, conclusions of law as submitted to this Court by the referee, the order is approved in every respect.

APPENDIX D

"Bankruptcy Act, 11 U.S.C. 1, et seq."

Section 2a. CREATION OF COURTS OF BANKRUPTCY AND THEIR JURISDICTION. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

(21) Require receivers or trustees appointed in proceedings not under this Act, assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person's property to deliver the property in their possession or under their control to the receiver or trustee appointed under this Act or, where an arrangement or plan under this Act has been confirmed and such property has not prior thereto been delivered to a receiver or trustee appointed under this Act, to deliver such property to the debtor or other person entitled to such property according to the provisions of the arrangement or plan, and in all such cases to account to the court for the disposition by them of the property of such bankrupt or debtor: *Provided, however,* That such delivery and accounting shall not be required except in proceedings under section 77 and chapters X and XII of this Act, if the receiver or trustee was appointed, the assignment was made, or the agent was authorized more than four months prior to the date of bankruptcy. Upon such accounting, the court shall reexamine and determine the propriety and reasonableness of all disbursements made out of such property by such receiver, trustee, assignee, or agent,

either to himself or to others, for services and expenses under such receivership, trusteeship, assignment, or agency, and shall, unless such disbursements have been approved, upon notice to creditors and other parties in interest, by a court of competent jurisdiction prior to the proceeding under this Act, surcharge such receiver, trustee, assignee, or agent the amount of any disbursement determined by the court to have been improper or excessive; and . . .

Section 64. DEBTS WHICH HAVE PRIORITY. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of title 18 of the United States Code, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the

reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding, including expenses necessarily incurred by a debtor in possession, receiver, or trustee in preparing the schedule and statement required to be filed by sections 238, 378, or 483, shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18 of the United States Code, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy; *Provided, however,* That no

priority over general unsecured claims shall pertain to taxes not included in the foregoing priority: *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; and (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision c of Section 67 of this Act: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

Section 67c(3). Every tax lien on personal property not accompanied by possession shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. Where such a tax lien is prior in right to liens indefeasible in bankruptcy, the court shall order payment from the proceeds derived from the sale of the personal property to which the tax lien attaches, less the actual cost of that sale, of an amount not in excess of the tax lien, to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. If the amount realized from the sale exceeds the total of such debts, after allowing for prior indefeasible liens and the cost of the sale, the excess up to the amount of the difference between the total paid to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and the amount of the tax lien, is to be paid to the holder of the tax lien.

Section 70a. TITLE TO PROPERTY. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of

the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located . . . (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this Act, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

"Internal Revenue Code of 1954, 26 U.S.C."

Section 6321. Lien for taxes

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. Aug. 16, 1954, c. 736, 68 A Stat. 779.

Section 6331. Levy and distraint

(a) Authority of Secretary or delegate—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401 (d)) of such officer, employee, or elected official. If the Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and

demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

Section 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. Aug. 16, 1954, c. 736, 68 A Stat. 828.

APPENDIX E

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In The Matter Of Chicagoland Ideel Cleaners, Inc., Bankrupt.	In Bankruptcy No. 71 B 5396

ORDER

At Chicago, Illinois, in said Division and District aforesaid, before the Honorable Charles B. McCormick, Referee in Bankruptcy, this 9th day of December, A.D., 1971:

This matter, CHICAGOLAND IDEEL CLEANERS, INC., as such assignee, and the answer thereto of the United States of America and the court having heard argument of counsel in open court and having considered the brief and memorandum submitted by the parties, finds:

That the court has jurisdiction of the parties and subject matter herein.

That Nathan Yorke is holding certain sums of money acquired by him as assignee for the benefit of the creditors of CHICAGOLAND IDEEL CLEANERS, INC., said assignment taking place prior to the service of notice of levy by the Internal Revenue Service upon said assignee.

That the notice of levy was served on the assignee on August 25, 1971 and on September 14, 1971 the involuntary petition in bankruptcy was filed herein and the receiver appointed and that adjudication has been entered.

That the notice of levy claimed all property rights to property monies, credits and bank deposits now in possession of and belonging to CHICAGOLAND IDEEL CLEANERS, INC.

That the notice of levy of the Internal Revenue Service herein could attach a lien only upon such interest as the taxpayer had in the property levied upon.

That the assignment for the benefit of creditors passed inalienable title to the assets of CHICAGOLAND IDEEL CLEANERS, INC., to the assignee for the benefit of its creditors.

That the notice of levy of the Internal Revenue Service is a nullity as it pertains to the bankrupt estate.

WHEREFORE IT IS HEREBY ORDERED, ADJUDGED AND DECREED that Nathan Yorke surrender and turn over to Craig Phelps, Receiver herein, any and all sums in his possession which were acquired by and through his performance as an assignee for the benefit of the creditors of the bankrupt herein.

Enter:

/s/ Charles B. McCormick
Referee in Bankruptcy

CORRECTED

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604
May 24, 1974

Before
Hon. JOHN S. HASTINGS, SR. *Circuit Judge*
Hon. WALTER J. CUMMINGS, *Circuit Judge*
Hon. JOHN PAUL STEVENS, *Circuit Judge*

In the Matter of:
CHICAGOLAND IDEEL CLEANERS, INC.,
Bankrupt,
Appellee,
No. 72-1620 vs.
UNITED STATES OF AMERICA,
Petitioner-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
(71 B 5396)

On consideration of the petition for rehearing filed in the above-entitled cause,

IT IS HEREBY ORDERED that the petition for rehearing in the above-entitled appeal be, and the same is hereby, DENIED.

Supreme Court, U. S.
FILED
JAN 28 1975
MICHAEL RODAK, JR., CLERK

No. 74-121

In the

Supreme Court of the United States

OCTOBER TERM, 1974

CRAIG PHELPS, RECEIVER IN BANKRUPTCY IN THE MATTER OF CHICAGOLAND IDEEL CLEANERS, INC, BANKRUPT,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petition for a Writ of Certiorari
Filed August 14, 1974
Certiorari Granted December 16, 1974

APPENDIX

KEVIN J. GILLOGLY
Suite 865
One North LaSalle Street
Chicago, Illinois 60602
Attorney for Petitioner

Of Counsel:
DANIEL C. AHERN
DENNIS E. QUAID

The Scheffer Press, Inc.—(312) 263-6850

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APPENDIX B

RELEVANT DOCKET ENTRIES

92 Cred. Sched. ADJUDICATED 9-28-71

CHICAGOLAND IDEEL CLEANERS, INC. 71 B 5206

9-14-71

5333 W. 25th Street

Cicero | Cook | Ill.

NO ASSET CASES ONLY
CLAIMS AS SCHEDULED

ATTORNEY FOR PETITIONING CREDITORS: Merovitz, Powell & Pizer
134 N. La Salle Fr. 2-9066

ATTORNEY FOR PETITIONING CREDITORS: Teller, Levit & Silvertrust Attention: Julius I.
1 La Salle Street St. 2-3970 Silvertrust)
60602

RECEIVER: Craig Phelps
53 W. Jackson

Kevin

ATTORNEY FOR RECEIVER: Kevin J. Gillogly
1 N. LaSalle 332-0767

TRUSTEE: Craig Phelps
53 W. Jackson

ATTORNEY FOR TRUSTEE: Kevin J. Gillogly
1 N. La'Salle 332-0767

BEST COPY AVAILABLE

DATE	PROCEEDINGS
9-14-71	Filed involuntary petition for adjudication by Leader Supply Co., Rich Supply House, Great Lakes Solvents, Toll Brothers Laundry, Lincoln Bag Co., Morgan Locksmiths and R. & D. Decorators ma
9-24-71	Ordered that Craig Phelps is appointed Receiver and; Further Ordered that Receiver give bond to U.S. in the sum of $10,000; Further Ordered that Receiver is authorized to take possession of all of the assets of estate and bankrupt or other persons are ordered to deliver forthwith all property now owned or in in possession of alleged bankrupt; Further Ordered that Receiver is directed to take personal and immediate charge of the assets and filed within 10 days an itemized inventory. (dft) McCormick, R. ma
9-28-71	Ordered that Chicagoland Ideel Cleaners is adjudged a bankrupt (dft) McCormick, R. ma
10-19-71	Filed notice; application of Receiver Enter Leave filed—20 days to answer or plead—11-23-71 at 2 p.m. Ref. McCormick ma
11- 5-71	Filed notice; application
11- 9-71	Filed answer of U.S. to Receiver's application ma
11- 9-71	Filed memorandum of U.S. in support of its answer ma
11-23-71	Hearing on application of Receiver for Nathan Yorke to turn over all sums in his possession acquired as an assignee. Under advisement.

11-22-71	Filed brief in support of the Receiver's right to assets held by Nathan Yorke ma
12- 9-71	Ordered that Nathan Yorke turn over to Receiver all the sums in his possession which he acquired while assignee (dft) McCormich, r. ma
12-16-71	Filed petition for review of order entered on 12-9-71 by James R. Thompson, United States Attorney
1- 5-72	Filed Referee's Certificate on Petition for Review
1- 6-72	Filed Notice of Filing of Certificate on Review. (Notices mailing 1-6-72)
1-11-72	Order: After careful review, the findings of fact, conclusions of law as submitted to this Court by the referee, the order is approved in every respect (dft) Lynch, J.
1-18-72	Filed memorandum of United States in support of petition for review ma
1-21-72	Trustee is given ten days to answer Government's motion. Government is given five days to reply. Order cause set for decision on February 11, 1972 at 2pm (dft) Lynch, J. (Notices mailed) ma
1-26-72	Filed notice of motion ma
1-31-72	Filed answer of Trustee to memorandum of United States in support of a Petition for Review ma
2-11-72	Filed further memorandum of United States in support of petition for review ma

2-11-72 The Government is given leave to file a reply brief within 10 days (dft) Lynch, J. ma

3- 2-72 Order: The motion to vacate the order of this Court affirming the decision of the Referee in bankruptcy is denied. This court has reviewed the Referee's findings and conclusions and the briefs of the parties and affirms the Referee's decision in every respect (dft) Lynch, J. (notices mailed)

3-13-72 Filed Memorandum in Support of United States Motion to reconsider order of Mar 2, 1972. mh (to Judge Lynch)

3-13-72 Filed United States Motion to reconsider order of 3/2/72 (to Judge Lynch)

4-28-72 Filed notice of appeal for United States of America

4-28-72 Mailed copy of notice of appeal to: Julian I. Sivertrust, Teller, Levit & Silvertrust, One North LaSalle, Chicago Illinois 60602; Nathan Yorke, 208 S. LaSalle, Chicago, Illinois 60604; Nachman, Munitz & Sweig, One First National Plaza; Kevin J. Gillogly, One North LaSalle; Craig Phelps, 53 W. Jackson Blvd. ma

7-23-74 Filed certified copy of United States Court of Appeals entered May 9, 1974 order Ordered and adjudged by this court that the order approving the turnover order the said District Court in this cause appealed from be, and the same is hereby, Reversed, in accordance with the opinion of this court filed this day. It is further ordered that costs be taxed in favor of the United States of America. Bill of costs attached. jvs

7-23-74 Filed certified copy of USCA Opinion. jvs

7-23-74 Filed certified copy of order of United States Court of Appeals entered on May 24, 1974: Ordered that the petition for rehearing in the above-entitled appeal be, and the same is hereby, denied. jvs

7-23-74 Complete record on appeal received. jvs

8-12-74 Filed Receiver's request to transmit complete record to U.S.S.C. ps

8-29-74 Filed Receiver's notice with Motion.

9- 5-74 Enter order dated 9-3-74: Enter order Receiver's motion to compel Clerk to transmit the original record to the Supreme Court. Austin, J.

IN THE UNITED STATES DISTRICT COURT

ASSIGNMENT

Whereas, Chicagoland Ideel Cleaners, Inc., an Illinois corporation, having its principal place of business at 733 North Pulaski Road, Chicago, Illinois and 5333 W. 25th Street, Cicero, Illinois, is indebted to diverse persons which it is presently unable to pay in full, and has decided to discontinue its business and is desirous of transferring all its property to a trustee for the benefit of all its creditors without any preference or priority, except such priority as is established and permitted by law;

Now, Therefore, Chicagoland Ideel Cleaners, Inc., an Illinois corporation (hereinafter referred to as Assignor), in consideration of its existing indebtedness to its creditors and the undertaking herein of Nathan Yorke, of Chicago, Illinois (hereinafter referred to as Assignee), does hereby assign, transfer and set over to said Nathan Yorke, not

individually but as Trustee and Assignee for the benefit of creditors of Assignor, all its property of every kind and description, real, personal and mixed, and wherever located, including but not limited to cash in banks and on hand, accounts receivable and good will (as well as the right to receive all incoming mail); to have and to hold the same unto the said Nathan Yorke, in trust, to receive, sell and dispose of the said property in the best manner and for the highest and best price or prices reasonably obtainable; to collect the claims of Assignor against third parties; to dispose of all claims of Assignor against third parties in the best and most reasonable manner as provided by law, and otherwise, so far as possible and in the best manner possible, to convert to cash all property of Assignor; and to properly carry out this trust, Assignee is empowered in his name or in the name of Assignor to collect, sue for or othrewise liquidate or dispose of any and all claims, demands or accounts due and payable to Assignor from whomsoever, and to dispose of all disputed claims asserted against Assignor in such manner as shall be in the best interest of the creditors of Assignor; and the Assignee shall disburse the proceeds realized from the sale or other disposition of Assignor's said property in the following manner;

1. Payment of the expenses of administration of the trust created hereby, including reasonable compensation to the Assignee and his attorney, the attorney for the Assignor, and to such other parties as shall be entitled thereto.
2. Distribute and pay the remainder of said proceeds to Assignor's creditors for all debts and liabilities which Assignor may owe including, but not limited to, those persons whose names are listed on Schedule A attached hereto and made a part hereof; provided, that if there shall not be sufficient funds with which to pay all of Assignor's debts, then said debts (except those entitled by law to priority) shall be paid pro rata.
3. If there should be any residue of said proceeds remaining after making the payments and distribution aforesaid, Assignee shall pay same to Assignor or its successors and assigns.
4. In the event of the death, inability or refusal to act, or, resignation of Nathan Yorke as Trustee-Assignee, then in such event Bernard Chaitman is hereby appointed as Successor Trustee-Assignee, with all the duties, rights and powers herein imposed upon and granted to Nathan Yorke as Trustee-Assignee.

Executed and delivered at Chicago, Illinois this 28 day of June, 1971.

Chicagoland Ideel Cleaners, Inc.
By /s/ Sam Slotky
President

Attest:
/s/ Solomon Slotky
Its Secretary

State of Illinois)
) SS
County of Cook)

I, Sydney R. Marovitz, a Notary Public in and for the County and State aforesaid, do hereby certify that Sam Slotky, President, and Solomon Slotky, Secretary of Chicagoland Ideel Cleaners, Inc. appeared before me this day in person and acknowledged to me that they signed the foregoing instrument as their free and voluntary act and as the free and voluntary act of said corporation, pursuant to directions and resolutions passed by the Stockholders and Board of Directors of said corporation, for the uses and purposes therein set forth.

Given under by hand and Notarial Seal this 28 day of June A.D. 1971.

/s/ Sydney R. Marovitz
Notary Public

IN THE UNITED STATES DISTRICT COURT

ACTION BY SHAREHOLDERS AND BOARD OF DIRECTORS BY UNANIMOUS WRITTEN CONSENT

We, the undersigned, being together the shareholders of all of the issued and outstanding shares of Chicagoland Ideel Cleaners, Inc. an Illinois corporation, and comprising all of the directors of said corporation, hereby consent in writing, without a meeting, pursuant to the authority of Sections 147 and 147.1 of the Illinois Business Corporation Act to the following action:

Resolved: That the corporation make an Assignment of all its assets to an Assignee for the benefit of creditors, and that the President and Secretary of the corporation execute all necessary papers and documents pertaining to an Assignment for the benefit of creditors to Nathan Yorke, as Assignee, and said Assignee shall be authorized to do any and all acts necessary in order to fully carry out the intent and purposes of such Assignment.

Further Resolved: That the Officers of this corporation are hereby empowered and directed to execute any and all other documents necessary to carry out the purposes to be contained in said Assignment for the benefit of creditors.

Dated: June 28, 1971

/s/ Sam Slotky
/s/ Solomon Slotky
/s/ Meyer Slotky
Shareholders and Directors.

IN THE UNITED STATES DISTRICT COURT

ACCEPTANCE

I, Nathan Yorke, the Trustee and Assignee hereinabove named, do hereby accept the trust hereinabove set forth, not individually but as Trustee and Assignee, subject to the conditions set forth above.

/s/ Nathan Yorke
Nathan Yorke

At Chicago, Illinois, June 28, 1971

IN THE UNITED STATES DISTRICT COURT

* * (Caption—In Bankruptcy No. 71 B 5396) * *

APPLICATION

To: The Honorable Charles B. McCormick,
Referee in Bankruptcy:

Now comes Craig Phelps, Receiver in Bankruptcy in the above entitled estate and represents to this Court as follows:

1. That he is the duly appointed and acting Receiver herein having qualified by filing his bond as approved by this Court.

2. That Nathan Yorke was an assignee for the benefit of creditors prior to the filing of the involuntary proceedings and adjudication in the subject proceedings; that he liquidated certain assets of the bankrupt while serving as such assignee and is presently in possession of these sums.

3. That demand has been made upon Nathan Yorke to surrender and turn over to the Receiver herein these assets; that Nathan Yorke has respectfully declined to surrender and turn over these assets because he was

served with a notice of levy by the Internal Revenue Service on August 25, 1971.

4. That the Internal Revenue Service acquired no lien rights or prior position to the Receiver herein by the service of a notice of levy on the assignee and that these funds being held by Nathan Yorke should be ordered and directed into the subject estate.

Wherefore, Craig Phelps, Receiver herein, prays for an order upon Nathan Yorke to surrender and turn over any and all assets of the bankrupt herein and for such other and further relief as the Court shall deem meet and just.

/s/ Craig Phelps
Craig Phelps, Receiver

IN THE UNITED STATES DISTRICT COURT

* * (Caption—In Bankruptcy No. 71 B 5396) * *

ANSWER OF UNITED STATES TO RECEIVER'S APPLICATION

The United States by William J. Bauer, United States Attorney for the Northern District of Illinois, in answer to the receiver's application for an order upon Nathan Yorke to surrender and turn over certain assets states:

1. This court of bankruptcy lacks jurisdiction over the subject matter of the application because the United States is entitled to the possession of the moneys now held by Nathan Yorke, assignee of the bankrupt. This court of bankruptcy does not have actual and cannot have constructive possession of the funds held by Mr. Yorke. Such possession is the basis of this court's jurisdiction on August 25, 1971. The Internal Revenue Service recorded its notice of Federal tax lien under Internal Revenue laws against Chicagoland Ideel Cleaners, Inc., 7333 N. Pulaski Road, Chicago, Illinois 60624, taxpayer,

with the Recorder of Deeds, Cook County, Illinois, Document No. 21598670 (Exhibit A attached) and served its notice of levy on Nathan Yorke, assignee, 208 S. LaSalle Street, Chicago, Illinois 60604, demanding payment from Mr. Yorke of any funds that he held belonging to the taxpayer, Chicagoland Ideel Cleaners, Inc. (Exhibit B attached), prior to the beginning of these bankruptcy proceedings. The United States as of August 25, 1971, has been entitled to possession of the funds now held by Mr. Yorke.

2. This court of bankruptcy lacks jurisdiction over the United States, in that the United States has not and does not consent to the adjudication of the controversy over the possession of the funds held by Nathan Yorke, assignee, by this court. The application cites no express grant of statutory authority giving the receiver the right to maintain this application against the United States.

3. There has been an insufficiency of service of process to bring the United States before this court of bankruptcy.

4. The application fails to state a claim against the United States upon which relief can be granted.

Wherefore, the United States prays that the receiver's application be dismissed.

/s/ William J. Bauer
William J. Bauer
United States Attorney

TJ :es

EXHIBIT A

State Of Illinois, }
County of Cook. } ss.

I, SIDNEY R. OLSEN, Recorder of Deeds, and Keeper of the Records of said Recorder of Deeds, in and for said County, in the State aforesaid, do hereby certify that the foregoing is a photographic copy of a document filed for record in the office of the Recorder of Deeds on Twenty-fifth day of August A.D. 1971 as Document No. 21598670.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed my seal at Chicago, this Second day of November A.D. 1971.

/s/ Sidney R. Olsen
Recorder of Deeds.

C:W:F10:BCS

- 14 -

Form 668 (Rev. 1-70) — DEPARTMENT OF THE TREASURY INTERNAL REVENUE SERVICE

NOTICE OF FEDERAL TAX LIEN UNDER INTERNAL REVENUE LAWS

For Optional Use By Recording Office

DISTRICT: CHICAGO

SERIAL NUMBER:

Pursuant to the provisions of Sections 6321, 6322, and 6323 of the Internal Revenue Code, notice is hereby given that there have been assessed under the Internal Revenue laws of the United States against the following named taxpayer, taxes (including interest and penalties) which after demand for payment thereof remain unpaid, and that by virtue of the above-mentioned statutes the amount of said taxes, together with penalties, interest, and costs that may accrue in addition thereto, is a lien in favor of the United States upon all property and rights to property belonging to said taxpayer.

NAME OF TAXPAYER
Chicagoland Idcol Cleaners, Inc.

RESIDENCE
733 N. Pulaski Rd.,
Chicago, Illinois 60624

KIND OF TAX (a)	TAX PERIOD ENDED (b)	ASSESSMENT DATE (c)	IDENTIFYING NUMBER (d)	UNPAID BALANCE OF ASSESSMENT (e)
941	12/31/70	05/28/71	36-2419291	$ 49,738.70
941	09/30/70	03/12/71	36-2419291	41,709.02
940	12/31/70	05/21/71	36-2419291	2,799.10
941	03/31/71	06/04/71	36-2419291	46,584.77
			TOTAL	$140,831.59

PLACE OF FILING
Recorder of Deeds
Cook County
Chicago, Illinois

WITNESS my hand at Chicago, Illinois, on this,
the 25th day of August, 1971

SIGNATURE: Howard J. Buchwa
TITLE: Revenue Officer

(NOTE: Certificate of officer authorized by law to take acknowledgments is not essential to the validity of Notice of Federal Tax Lien G.C.M. 26419, C.B. 1950-51, 125.)

PART 2—To be receipted and returned to the Internal Revenue Service

BEST COPY AVAILABLE

Form 668-A (Rev. Feb. 1967)

DATE

03/24/71

U S TREASURY DEPARTMENT — INTERNAL REVENUE SERVICE

Attn: S/O B.C.Samuels
Group 10

NOTICE OF LEVY

West Field Branch, 5817 W. Madison St., Chicago, Ill. 60644

TO Nathan Yorke, Assignee
200 South LaSalle Street
Chicago, Illinois 60604

INTERNAL REVENUE SERVICE

ORIGINATING DISTRICT
CHICAGO

You are hereby notified that there is now due, owing and unpaid to the United States of America from the taxpayer whose name appears below the sum of → $ 145,820.94

TAX FORM NO.	PERIOD ENDED	DATE OF ASSESSMENT	IDENTIFYING NO.	UNPAID BALANCE OF ASSESSMENT	STATUTORY ADDITIONS	TOTAL
941	09/30/70	03/12/71	36-2419291	$ 41,709.02	$ 1,162.78	$
				LPP	1,174.98	44,046.78
941	12/31/70	05/28/71	36-2419291	49,738.70	760.85	
				LPP	697.64	51,197.19
940	12/31/70	05/21/71	36-2419291	2,799.10	46.16	
				LPP	41.23	2,886.51
941	03/31/71	06/07/71	36-2419291	46,584.77	663.61	
				LPP	437.08	47,690.46
				Lien Fee	6.00	
				TOTAL AMOUNT DUE		145,820.94

Computed thru 8/2/71

You are further notified that demand has been made for the amount set forth herein upon the taxpayer who has neglected or refused to pay, and that such amount is still due, owing, and unpaid from this taxpayer. Accordingly, you are further notified that all property, rights to property, moneys, credits, and bank deposits now in your possession and belonging to this taxpayer (or with respect to which you are obligated) and all sums of money or other obligations owing from you to this taxpayer, or on which there is a lien provided under Chapter 64, Internal Revenue Code of 1954, are hereby levied upon and seized for satisfaction of the aforesaid tax, together with all additions provided by law, and demand is hereby made upon you for the amount necessary to satisfy the liability set forth herein, or for such lesser sum as you may be indebted to him, to be applied as a payment on his tax liability. Checks or money orders should be made payable to "Internal Revenue Service".

SIGNATURE	TITLE	ADDRESS (CITY AND STATE)
[signature]	Revenue Officer	5817 W. Madison St. Chicago, Illinois 60644

(Name and Address of Taxpayer)

Chicagoland Ideel Cleaners, Inc.,
733 N. Pulaski Road
Chicago, Illinois 60624

CERTIFICATE OF SERVICE

I hereby certify that this levy was served by delivering a copy of this notice of levy to the person named below.

NAME [signature]

TITLE Assignee

DATE AND TIME 8/25/71 - 3:40 P.M.

SIGNATURE OF REVENUE OFFICER [signature]

PART 2 — TO BE RETAINED BY ADDRESSEE

Form 668-A (Rev. 2-67)

BEST COPY AVAILABLE

UNITED STATES DISTRICT COURT

* * (Caption—In Bankruptcy No. 71 B 5396) * *

ORDER

At Chicago, Illinois, in said Division and District aforesaid, before the Honorable Charles B. McCormick, Referee in Bankruptcy, this 9th day of December, A.D., 1971:

This matter, Chicagoland Ideel Cleaners, Inc., as such assignee, and the answer thereto of the United States of America and the court having heard argument of counsel in open court and having considered the brief and memorandum submitted by the parties, finds:

That the court has jurisdiction of the parties and subject matter herein.

That Nathan Yorke is holding certain sums of money acquired by him as assignee for the benefit of the creditors of Chicagoland Ideel Cleaners, Inc., said assignment taking place prior to the service of notice of levy by the Internal Revenue Service upon said assignee.

That the notice of levy was served on the assignee on August 25, 1971 and on September 14, 1971 the involuntary petition in bankruptcy was filed herein and the receiver appointed and that adjudication has been entered.

That the notice of levy claimed all property rights to property monies, credits and bank deposits now in possession of and belonging to Chicagoland Ideel Cleaners, Inc.

That the notice of levy of the Internal Revenue Service herein could attach a lien only upon such interest as the taxpayer had in the property levied upon.

That the assignment for the benefit of creditors passed inalienable title to the assets of Chicagoland Ideel Cleaners, Inc., to the assignee for the benefit of its creditors.

That the notice of levy of the Internal Revenue Service is a nullity as it pertains to the bankrupt estate.

Wherefore It Is Hereby Ordered, Adjudged And Decreed that Nathan Yorke surrender and turn over to Craig Phelps, Receiver herein, any and all sums in his possession which were acquired by and through his performance as an assignee for the benefit of the creditors of the bankrupt herein.

Enter:

/s/ Charles B. McCormick
Referee in Bankruptcy

UNITED STATES DISTRICT COURT

• • (Caption—In Bankruptcy No. 71 B 5396) • •

PETITION FOR REVIEW

To the honorable judges of the United States District Court for the Northern District of Illinois:

Now comes James R. Thompson, United States Attorney for the Northern District of Illinois, and respectfully represents:

1. Petitioner, United States of America, is aggrieved by the order herein entered by the Honorable Charles B. McCormick, Referee in Bankruptcy, on December 9, 1971, a copy of which is attached as exhibit "A".

2. The referee erred in that the findings of fact are not supported by the evidence and the conclusions of law are contrary to law.

Wherefore, the United States of America prays that the order of December 9, 1971, be reviewed by a judge of this court in accordance with provisions of the Bankruptcy Act, that the order be reversed, that the application of Craig Phelps, receiver, for an order upon Nathan Yorke to surrender and turn over any funds be denied and that your petitioner have such other and further relief as is just.

Respectfully submitted,

/s/ James R. Thompson
James R. Thompson
United States Attorney

December 16, 1971

UNITED STATES DISTRICT COURT

• • (Caption—In Bankruptcy No. 71 B 5396) • •

CERTIFICATE ON PETITION FOR REVIEW

(Filed January 5, 1972)

To The Honorable
Judge Of The United States District Court,
For The Northern District Of Illinois,
Eastern Division, In Bankruptcy Sitting:

Honorable Sir:

I, Charles B. McCormick, Referee in Bankruptcy, herein, on petition to review an order dated December 9, 1971 do hereby certify and transmit herewith the following:

TRANSMITTED HEREWITH

1. Receiver's application for an order on the assignee for the benefit of creditors for a turnover of liquidated assets.

2. Government's answer to the application of the receiver.
3. Receiver's brief in support of application for a turnover.
4. Government's memorandum in support of its answer to receiver's application.
5. Referee's order of December 9, 1971.
6. Government's petition for review of the Referee's order of December 9, 1971.

STATEMENT OF FACTS

There is little, if any, dispute as to the facts involved herein. The parties agree that:

(a) An assignment for the benefit of creditors was made by Chicagoland Ideel Cleaners, Inc., on June 28, 1971.

(b) That the assignee thereafter proceeded to liquidate the assignor's assets.

(c) An August 25, 1971, after the aforesaid liquidation, the Internal Revenue Department served a notice of levy on the assignee claiming all assets in his possession *belonging to Chicagoland Ideel Cleaners, Inc.*

(d) On September 14, 1971 an involuntary petition in bankruptcy was filed, a receiver was appointed and adjudication has been entered.

ISSUES FOR DETERMINATION

1. Whether the Internal Revenue Service's notice of levy served after the assignor's (now the bankrupt) assignment for the benefit of creditors gave a superior property right to that agency as opposed to the receiver in bankruptcy.

2. Whether this court has summary jurisdiction over the assets in the possession of the assignee for the benefit of creditors.

FINDINGS

The referee's findings are contained in the order under review and were made after considering the reasoning and citations set forth in the brief and the memorandum submitted herewith. The questions are questions of law and the court found the authorities submitted by the receiver to be the more relevant and conclusive.

Very little oral argument was had in open court and it is the opinion of the referee that a transcript thereof, unless desired by either or both of the parties, is unnecessary for the attention of the reviewing court.

HEARING ON THIS CERTIFICATE

This certificate to be set down for hearing on your Motion calendar.

Respectfully submitted,
/s/ Charles B. McCormick
Referee in Bankruptcy

UNITED STATES DISTRICT COURT,

Name of Presiding Judge, Honorable William J. Lynch

Cause No. 71 B 5396 Date Jan 11, 1972

Title of Cause
In the Matter of Chicagoland Ideel Cleaners, Inc

Brief Statement of Motion
Petition for Review

ORDER: After careful review, the findings of fact, conclusions of law as submitted to this Court by the referee, the order is approved in every respect.

[Initialed] W.J.L.

Notices mailed 1-14-72

UNITED STATES DISTRICT COURT,

Name of Presiding Judge, Honorable William J. Lynch

Cause No. 71 B 5396 Date 3/2/72

Title of Cause

In The Matter of Chicagoland Ideel Cleaners, Inc.

ORDER: The motion to vacate the order of this Court affirming the decision of the Referee in bankruptcy is denied. This Court has reviewed the Referee's findings and conclusions and the briefs of the parties and affirms the Referee's decision in every respect.

Approved:

/s/ W. J. Lynch

IN THE UNITED STATES DISTRICT COURT

• • (Caption—In Bankruptcy No. 71 B 5396) • •

NOTICE OF APPEAL

Notice is hereby given that the United States of America, petitioner for review in the District Court, hereby appeals to the United States Court of Appeals for the Seventh Circuit from the final judgment entered in these proceedings on January 11, 1972, affirming the order entered on December 9, 1971 by the Honorable Charles B. McCormick, Referee in Bankruptcy. The time for filing the notice of appeal commenced to run on March 2, 1972, the date on which the District Court denied the timely motion of the United States of America made pursuant to

rule 59 to vacate the District Court's order affirming the order of the Referee in Bankruptcy.

/s/ James R. Thompson
James R. Thompson
United States Attorney

April 28, 1972

Service of this notice is to be made on:

Julian I. Silvertrust
Teller, Levit & Silvertrust
One North LaSalle Street
Chicago, Illinois 60602

Kevin J. Gillogly
One North LaSalle Street
Chicago, Illinois 60602

Nathan Yorke
208 South LaSalle Street
Chicago, Illinois 60604

Craig Phelps
53 West Jackson Blvd.
Chicago, Illinois 60604

Nachman, Munitz & Sweig
One First National Plaza
Chicago, Illinois 60670

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

May 24, 1974

Before

Hon. JOHN S. HASTINGS, SR., *Circuit Judge*

Hon. WALTER J. CUMMINGS, *Circuit Judge*

Hon. JOHN PAUL STEVENS, *Circuit Judge*

In the Matter of:

CHICAGOLAND IDEEL CLEANERS, INC., BANKRUPT,
Appellee,

No. 72-1620 vs.

UNITED STATES OF AMERICA,
Petitioner-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

(71 B 5396)

On consideration of the petition for rehearing filed in the above-entitled cause,

IT IS HEREBY ORDERED that the petition for rehearing in the above-entitled appeal be, and the same is hereby, DENIED.

Supreme Court, U. S.
FILED
NOV 27 1974
MICHAEL RODAK, JR., CLERK

No. 74-121

In the Supreme Court of the United States

OCTOBER TERM, 1974

CRAIG PHELPS, RECEIVER IN BANKRUPTCY OF CHICAGOLAND IDEEL CLEANERS, INC., BANKRUPT, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

ROBERT H. BORK,
Solicitor General,

SCOTT P. CRAMPTON,
Assistant Attorney General,

CROMBIE J. D. GARRETT,
KARL SCHMEIDLER,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-121

CRAIG PHELPS, RECEIVER IN BANKRUPTCY OF CHICAGOLAND IDEEL CLEANERS, INC., BANKRUPT, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

OPINION BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 495 F. 2d 1283.

JURISDICTION

The judgment of the court of appeals (Pet. App. B) was entered on May 7, 1974. A timely petition for rehearing was denied on May 24, 1974. The petition for a writ of certiorari was filed on August 14, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a bankruptcy court has summary jurisdiction to order the collection of an assignee's liability to a bankrupt taxpayer where, prior to bankruptcy, the Internal

Revenue Service had served the assignee with a notice of levy with respect to that liability and had made demand for payment pursuant thereto.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 2a(21) and 67c(3) of the Bankruptcy Act, as amended, 11 U.S.C. 11(a)(21) and 107(c)(3), and Sections 6321 and 6331 of the Internal Revenue Code of 1954, 26 U.S.C. 6321 and 6331, are set forth at Pet. App. D.

Section 6332 of the Internal Revenue Code of 1954, as amended, 26 U.S.C. 6332, in pertinent part provides:

> (a) * * * [A]ny person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate * * *.
> * * * * *
>
> (c)(1) Any person who fails or refuses to surrender any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered * * *.
>
> * * * * *
>
> (d) Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made who, upon demand by the Secretary or his delegate, surrenders such property or rights to property (or discharges such obligation) to the Secretary or his delegate * * * shall be discharged from any obligation or liability to the delinquent taxpayer with respect to such property or rights to property arising from such surrender or payment. * * *

Section 301.6331-1(a)(1) of the Treasury Regulations on Procedure and Administration, 26 C.F.R. 301.6331-1(a)(1), in pertinent part provides:

> If any person liable to pay any tax neglects or refuses to pay such tax within 10 days after notice and demand, the district director to whom the assessment is charged * * * may proceed to collect the tax by levy upon any property, or rights to property, whether real or personal, tangible or intangible, either belonging to such person or with respect to which there is a lien provided by section 6321 or 6324 * * * for the payment of such tax. * * * Property subject to a Federal tax lien which has been sold or otherwise transferred by the taxpayer may be seized while in the hand of the transferee * * *. Levy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy including receivables, bank accounts, evidences of debt, securities, and accrued salaries, wages, commissions, and other compensation. * * *

STATEMENT

During the spring of 1971, the Internal Revenue Service made assessments against Chicagoland Ideel Cleaners, Inc., of federal income and social security withholding taxes, and federal unemployment taxes, in the total

amount of $140,831.59.[1] Chicagoland subsequently assigned all its assets to an individual, Nathan Yorke, for the benefit of its creditors. Yorke liquidated the assets and held the proceeds. The Service then filed notice of a federal tax lien for the taxes previously assessed, served Yorke with a notice of levy, and demanded payment.

Shortly thereafter, an involuntary petition in bankruptcy was filed against Chicagoland. A receiver was appointed and Chicagoland was adjudicated bankrupt. The receiver then filed an application with the referee for an order requiring Yorke, who had not yet complied with the Service's demand for payment, to turn over the proceeds from the sale of Chicagoland's assets. The referee ordered the funds turned over to the receiver and the district court affirmed. The court of appeals reversed (Pet. App. A), holding that the levy had transferred possessory interest in the funds from Chicagoland to the United States and therefore that the bankruptcy court lacked summary jurisdiction to order the funds paid over to the receiver.

DISCUSSION

1. a. A bankruptcy court may order property turned over to the receiver only if the court has summary jurisdiction to adjudicate the underlying controversy between the receiver and the adverse claimant to that property; a turnover order may not issue where the claimant is entitled to have his claim adjudicated in a plenary action. See generally 2 Collier, *Bankruptcy*, para. 23.10 (14th ed.), and cases there cited.

---

[1]The assessment gave rise to tax liens against all Chicagoland's property and rights to property. See Section 6321 of the Internal Revenue Code of 1954, 26 U.S.C. 6321. These liens were perfected by the subsequent filing of a notice of tax lien. See Section 6323 of the Code.

The general principles governing the scope of a bankruptcy court's summary jurisdiction over controversies between claimants and the trustee or receiver regarding property claimed to be part of the estate have been succinctly stated as follows:

> Generally speaking, where the controversy is one concerning property in the actual or constructive possession of the bankruptcy court, that court may adjudicate summarily all rights and claims pertaining thereto. Where the controversy is one involving property in the actual or constructive possession of a third person asserting a *bona fide* adverse claim, the bankruptcy court has no jurisdiction to determine summarily that person's claim upon petition by the receiver or trustee, unless by that person's consent. [2 Collier, *supra*, para. 23.04[2].]

A third person asserting a *bona fide* adverse claim is accordingly entitled to have his claims against property in his actual or constructive possession adjudicated in a plenary action. 2 Collier, *supra*, para. 23.06. That property is not subject to turnover.

The question before the courts below, therefore, was whether the service of the notice of levy with respect to Yorke's obligation as assignee transferred constructive possession of that obligation from Chicagoland to the United States for the purposes of the Bankruptcy Act. The court of appeals correctly determined that the notice of levy did have that effect.

b. Section 6331 of the Code provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, * * * the Secretary * * * [may] collect such tax * * * by levy upon all property and rights to property * * *belonging

to such person or on which there is a lien * * * for the payment of such tax." Tangible property in the taxpayer's possession is of course subject to levy by physical seizure. But levy need not, and in many cases cannot, take the form of physical seizure when the asset in question is the taxpayer's right to payment from a third person. For that reason, the Treasury Regulations provide that "[l]evy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy including receivables, bank accounts, evidences of debt, securities, and accrued salaries, wages, commissions, and other compensation." 26 C.F.R. 301.6331-1(a)(1).

The legal consequence of the service of notice of levy was to transfer effective ownership of Yorke's obligation from Chicagoland to the United States. See Section 6332 of the Code. Yorke's failure or refusal to make payment of the funds to the United States after demand, if persisted in, would subject him to personal liability for "a sum equal to the value of the property or rights not so surrendered." Section 6332(c)(1) of the Code. Thus upon levy and demand the United States, and not the taxpayer, becomes the primary obligee and holds constructive possession of the right to payment.

For these reasons, most courts of appeals that have considered the question have concluded that a bankruptcy court may not, in the absence of the government's consent, order the collection of a liability with respect to which levy and demand had already been made. See *Rosenblum* v. *United States*, 300 F. 2d 843 (C.A. 1); *United States* v. *Eiland*, 223 F. 2d 118 (C.A. 4). Cf. *United States* v. *Pittman*, 449 F. 2d 623 (C.A. 7); *In re Brewster-Raymond Co.*, 344 F. 2d 903 (C.A. 6). There is, however, an acknowledged conflict among the

courts of appeals. The Ninth Circuit, in *In re United General Wood Products Corp.*, 483 F. 2d 975, held that bankruptcy courts have summary jurisdiction to order payment of the amount of the liability to the receiver or trustee in such circumstances. We believe that this conflict should be resolved.

c. The question presented here is important to the administration of the internal revenue laws. Service of notice of levy with respect to a taxpayer's rights to property is often used as a means of enforcing collection of taxes. This is, for example, a common means of reaching a taxpayer's bank accounts. The current conflict among the courts of appeals means that the Internal Revenue Service lacks authoritative guidance as to whether it may rely upon such a levy in circumstances where the taxpayer is suspected of being in precarious financial straits.

2. In addition to the above question, which is comprehended by petitioner's first three questions presented (see Pet. 2), petitioner contends (Pet. 9) that in opposing the turnover order the government is required to carry the burden of coming forward with evidence that it had satisfied the statutory requirements of notice and demand (see Section 6331(a) of the Code) before it served the notice of levy. In rejecting that contention the court of appeals properly noted (Pet. App. A, pp. 2a-3a; footnote omitted):

> The notice of tax lien and the notice of levy both recite that the taxes remained unpaid after demand. These notices are regular on their face. Where, as here, the receiver has not come forward with any evidence suggesting that demands were not made, we will accept the recitations in the notices.

Petitioner cites no basis for his contention and we see none. It is insubstantial and warrants no further review.

CONCLUSION

For the foregoing reasons, we do not oppose the granting of the petition for a writ of certiorari, limited to the first three questions presented.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General.

SCOTT P. CRAMPTON,
Assistant Attorney General.

CROMBIE J. D. GARRETT,
KARL SCHMEIDLER,
Attorneys.

NOVEMBER 1974.

DOJ-1974-11

Supreme Court, U. S.
FILED
JAN 28 1975
MICHAEL RODAK, JR., CLERK

No. 74-121

In the Supreme Court of the United States

OCTOBER TERM, 1974

CRAIG PHELPS, RECEIVER IN BANKRUPTCY IN THE MATTER OF CHICAGOLAND IDEEL CLEANERS, INC, BANKRUPT,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE PETITIONER

KEVIN J. GILLOGLY
Suite 865
One North LaSalle Street
Chicago, Illinois 60602
Attorney for Petitioner

Of Counsel:
DANIEL C. AHERN
DENNIS E. QUAID

The Scheffer Press, Inc.—(312) 263-6850

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

No. 74-121

CRAIG PHELPS, RECEIVER IN BANKRUPTCY IN THE MATTER OF CHICAGOLAND IDEEL CLEANERS, INC, BANKRUPT,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF THE PETITIONER

OPINIONS BELOW

A Writ Of Certiorari issued to the United States Court of Appeals for the Seventh Circuit to review its judgment dated May 7, 1974. The opinion of the Court of Appeals was reported at 495 F.2d 1283 (7th Cir. 1974) and reported unofficially at 74-1 U.S.T.C. 84035.

The orders of the United States District Court for the Northern District of Illinois, Eastern Division, William J. Lynch, and the Referee in Bankruptcy (now Bankruptcy Judge), Charles B. McCormick, are not reported.

STATEMENT OF JURISDICTION

The cause presented for review is a proceeding in bankruptcy, prosecuted by the Receiver, and now Trustee, in bankruptcy. Jurisdiction is conferred upon this Court by 28 U.S.C. 1254(1) and the Bankruptcy Act, Section 24c, 11 U.S.C. 47c.

The judgment of the United States Court of Appeals for the Seventh Circuit was entered May 7, 1974, and mandate returned to the District Court on July 15, 1974. A petition for rehearing was filed on May 20, 1974, and denied by order dated May 24, 1974. The petition for a writ of certiorari was filed on August 14, 1974, and certiorari was granted on December 16, 1974.

STATUTES INVOLVED

The statutory provisions involved in this case are the Bankruptcy Act, 11 U.S.C. 1, et seq.: Sections 2a(21), 11 U.S.C. 11a(21); 64, 11 U.S.C. 104; 67c(3), 11 U.S.C. 107c; 70a(8), 11 U.S.C. 110a(8); and the Internal Revenue Code of 1954, Sections 6321, 26 U.S.C. 6321; 6322, 26 U.S.C. 6322; 6323, 26 U.S.C. 6323; 6331, 26 U.S.C. 6331; and 6672, 26 U.S.C. 6672, all of which are set forth in full in the Appendix hereto.

QUESTIONS PRESENTED FOR REVIEW

First: Whether the Court of Appeals incorrectly granted to the United States a priority based upon the Internal Revenue Code of 1954 for taxes in violation of and contrary to the priorities for payment of claims established by the Bankruptcy Act?

Second: Whether the Court of Appeals incorrectly held that service of a Notice of Levy upon an assignee

for the benefit of creditors subsequent to the assignment reduced the bankrupt's property then held by the assignee to the constructive possession of the United States?

Third: Whether the Court of Appeals incorrectly determined that the Bankruptcy Court lacked summary jurisdiction to adjudicate the controversy before it without the consent of the United States?

STATEMENT OF THE CASE

The bankrupt, Chicagoland Ideel Cleaners, Inc., is an Illinois corporation with its principal place of business in Chicago, Illinois. On June 28, 1971, the directors of the bankrupt corporation executed written consents (A. 8) to a general assignment (A. 5) of its assets for the benefit of creditors and on that date the bankrupt did assign and transfer all of its assets to Nathan Yorke, as assignee for the benefit of creditors. The assignee liquidated the assets of the bankrupt by sale and thereafter, on August 25, 1971, the Internal Revenue Service filed a Notice of Tax Lien (A. 10) with the Recorder of Deeds for the County of Cook, claiming a lien on the property or rights to property belonging to Chicagoland Ideel Cleaners, Inc., based upon assessments (A. 10) of March 12, May 5, May 28 and June 4, 1971, allegedly after demand, in the amount of $140,831.59. On the same date, the Internal Revenue Service effected a Notice of Levy (A. 10) upon Nathan Yorke, the assignee, without any further effort to reduce the proceeds to its possession.

An involuntary petition in bankruptcy was filed on September 14, 1971, against Chicagoland Ideel Cleaners, Inc., and Craig Phelps was appointed as Receiver on September 24, 1971. Chicagoland Ideel Cleaners, Inc., was adjudged a bankrupt on September 28, 1971.

On October 19, 1971, the Receiver filed an application (A. 9) requesting an order compelling the assignee to surrender and turn over to the Receiver the proceeds of his sale in his possession. By way of intervention, the United States answered (A. 10) the Receiver's application against the assignee by asserting that the Bankruptcy Court lacked jurisdiction over the United States and also lacked summary jurisdiction because the United States was entitled to possession of the monies held by the assignee. On December 9, 1971, the Referee in Bankruptcy ordered (A. 15) the assignee to turn over these proceeds to the Receiver. The United States filed a Petition for Review (A. 16) on December 16, 1971. The Referee's order was approved by the United States District Court for the Northern District of Illinois, Eastern Division, on January 11, 1972 (A. 19), whereupon the United States moved on January 21, 1972, to vacate the District Court's order. The motion to vacate was denied on March 2, 1972 (A. 20).

A Notice of Appeal (A. 20) to the United States Court of Appeals for the Seventh Circuit was filed on April 28, 1972, on behalf of the United States. The Court of Appeals (Pet. App. A) on May 7, 1974, reversed the January 11, 1972, order of the District Court (A. 19) approving the decision of the Referee in Bankruptcy. The Receiver filed a Petition for Rehearing which was denied on May 24, 1974. The Receiver filed a Petition with this Court for a Writ of Certiorari to review the judgment of the Court of Appeals on August 14, 1974, which was granted on December 16, 1974.

SUMMARY OF ARGUMENT

I.

The United States of America failed to record a Notice of Tax Lien as required by Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), prior to the sale of the taxpayer's property conducted by the assignee for the benefit of creditors. The purchasers at the sale obtained rights superior to an unrecorded federal tax lien, which is invalid as to them. Section 6323(a), *supra*. The federal tax lien failed and could not attach to the proceeds of the sale due to a termination of any property interest belonging to the taxpayer. *United States* v. *Bess*, 357 U.S. 51, 78 S. Ct. 1054, 2 L. Ed. 2d 1135 (1958). The proceeds passed into a trust estate created by the assignment and administered by the assignee as Trustee for the benefit of creditors as *cestuis que* trusts. *Levy* v. *Chicago National Bank*, 57 Ill. App. 143 (First Dist. 1894), *rev'd on other grounds*: 158 Ill. 88, 42 N.E. 128 and *Levy* v. *Metropolitan National Bank*, 158 Ill. 258, 42 N.E. 134. Consequently, no property or rights to property belonging to the taxpayer existed upon which the lien could attach. The opinion of the Court of Appeals for the Seventh Circuit erroneously granted lien rights to the United States and, in effect, created an additional and unwarranted first class priority to Section 64 of the Bankruptcy Act, 11 U.S.C. 104, based upon the Internal Revenue Code of 1954, in violation of and contrary to the priorities established by Congress in the Bankruptcy Act. The Bankruptcy Act is the foremost statement of federal policy concerning priorities in collective insolvency proceedings, *United States* v. *Randall*, 401 U.S. 513, 91 S. Ct. 991, 28 L. Ed. 2d 273 (1971), and is entitled to prevail over the provisions

of the Internal Revenue Code of 1954. *In Re United General Wood Products Corp.,* 483 F.2d 975 (9th Cir. 1973). The rights of the United States have been adequately protected by both statutory provisions without judicial amendment to the priorities of the Bankruptcy Act. The decision of *United States* v. *Eiland,* 223 F.2d 118 (4th Cir. 1955) relied upon by the United States should be distinguished and confined to its factual circumstances.

II.

The rights of the United States of America, even assuming, *arguendo,* that it did enjoy a federal tax lien, were postponed to the payment of expenses of administration and priority wage claims. Section 67c(3), 11 U.S.C. 107c(3), postpones to a third priority a tax lien on personal property not accompanied by possession. The policy of the Bankruptcy Act as expressed in Congressional amendments thereto, has been to subordinate tax claims and to favor expenses of administration and wage claims. H. Rept. 868 on H.R. 136, 89th Cong. 1st Sess. (1965). In accordance with this policy, the status of tax claims has been restricted through the adoption of a postponement provision in Section 67c(3), 11 U.S.C. 107c(3), which depends upon the existence of a possessory interest. Actual possession of the personalty is required in order to avoid postponement. *Goggin* v. *Division of Labor Law Enforcement of California,* 336 U.S. 118, 69 S. Ct. 469, 93 L. Ed. 543 (1949). A contrary result would constitute the utilization of legal fictions based upon the Internal Revenue Code of 1954 to override the system of priorities created in the Bankruptcy Act. *In Re United General Wood Products Corp., supra*; *United States* v. *Randall, supra.*

III.

The Bankruptcy Court enjoyed summary jurisdiction to adjudicate the controversy before it. The action originally was a dispute between the representative appointed by the Bankruptcy Court and an assignee for the benefit of creditors. Express provisions of the Bankruptcy Act grant summary jurisdiction to an action by the bankruptcy representative to require the assignee for the benefit of creditors to turn over the assets held by the latter in order to facilitate the expeditious and orderly administration of the bankruptcy estate. Sections 2a(21), 11 U.S.C. 11a(21); 70a(8), 11 U.S.C. 110a(8). The United States chose to intervene into the existing, summary proceedings and is bound by the nature of the proceedings. The United States cannot intervene into a proceeding for the purpose of objecting to the exercise of jurisdiction of the proceeding into which it is intervening.

ARGUMENT

I.

THE UNITED STATES FAILED TO RECORD ITS NOTICE OF LIEN PRIOR TO THE INTERVENTION OF THE RIGHTS OF THE ASSIGNEE'S PURCHASERS, AGAINST WHOM THE LIEN IS INVALID UNDER SECTION 6323(a) OF THE INTERNAL REVENUE CODE OF 1954, AND THE LIEN DID NOT ATTACH TO THE PROCEEDS HELD BY THE ASSIGNEE IN TRUST FOR THE BENEFIT OF CREDITORS.

The United States of America did not obtain a lien upon the property of Chicagoland Ideel Cleaners, Inc., the taxpayer and subsequently, the bankrupt, which entitled the United States to utilize the proceeds of the liquidation of the taxpayer's property to the exclusion of the rights of the Receiver in Bankruptcy. The lien claimed by the United States arises by virtue of statute, Section 6321 of the Internal Revenue Code of 1954, 26 U.S.C. 6321, and extends no further than the boundaries of that statute. The lien arises at the time of the administrative action of the Internal Revenue Service in making an assessment and demand for payment of the taxes,[1] Section 6322 of the Internal Revenue Code of 1954, 26 U.S.C. 6322, and is not valid against any purchaser, secured party, mechanic's lienor, or judgment lien creditor until the Notice of the Tax Lien has properly been filed or recorded. Section 6323(a) of the Internal Revenue Code

[1] Section 6322 provides that the lien arises "at the time of assessment", but Section 6321 makes demand a precondition to the creation of the lien which therefore arises as of the date of demand and non-payment but relates back to the date of assessment pursuant to Section 6322.

of 1954, 26 U.S.C. 6323(a). In the present case, the rights of purchasers from the assignee for the benefit of creditors during his liquidation of the taxpayer's assets intervened between the date of assessments, the last being made on June 4, 1971, and the date of the recordation, August 25, 1971, of the Notice of Tax Lien at the office of the Recorder of Deeds of Cook County, Illinois. By the terms of Section 6323(a), the lien of the United States lost its validity as of the assignee's sale and the purported levy thereafter served upon the assignee for the benefit of creditors was ineffective in attempting to reach the taxpayer's former property which was no longer burdened by the lien of the United States. Thereafter, on September 14, 1971, the date of the bankruptcy, the proceeds of the sale held by the assignee passed into the constructive possession of the Bankruptcy Court free of the previous lien of the United States and provided the basis for that Court's summary jurisdiction. *Taubel-Scott-Kitzmiller Co.* v. *Fox*, 264 U.S. 426, 44 S. Ct. 396, 68 L. Ed. 770 (1924).

By its nature, the federal tax lien is a "secret lien", unknown to third parties who have no means of discovering the existence of the assessment until the Internal Revenue Service files its Notice of Tax Lien or asserts its rights under the lien. *United States* v. *Texas Eastern Transmission Corp.*, 254 F. Supp. 114, 117 (W.D., La. 1965); *United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 73 S. Ct. 701, 97 L. Ed. 1071 (1953); *Marteney* v. *United States*, 245 F.2d 135 (10th Cir. 1957). This aspect of the lien's nature is attributable to the fact that it arises from an administrative action rather than as the result of judicial action. There exists no public record or other means available to third parties to learn of the lien's creation and, consequently, those persons whose

rights are junior to an unrecorded tax lien under Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), are in jeopardy of extending further credit to the taxpayer based upon the strength of its apparent assets which may already be subject to a prior federal tax lien.[2] In these situations, there is no method through which a general creditor can adequately protect himself. Such being the nature of the federal tax lien, the Petitioner, as representative of the general unsecured creditors, urges this Honorable Court to restrict the force and effect of the lien to its statutory limits.

When the sale of the taxpayer's property was conducted by the assignee pursuant to the authority of the assignment, the Internal Revenue Service had not recorded a Notice of Tax Lien. Pursuant to Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), the lien of the United States at this stage was not valid against the assignee's purchasers, who received unencumbered title.

The determination of whether a particular person qualifies as a purchaser is a matter of federal, rather than state law. *United States* v. *Hoper,* 242 F.2d 468, 470 (7th Cir. 1957). This Honorable Court had cause to consider the definition of a purchaser under the predecessor in the Internal Revenue Code of 1939, to Section 6323(a), which was Section 3672 in the case of *United States* v. *Scovil,* 348 U.S. 218, 75 S. Ct. 244, 99 L. Ed. 271 (1955). The *Scovil* Court determined that a purchaser for this purpose usually means one who acquires title for a valuable consideration in the manner of a vendor and vendee. Section 6323(a) itself has been interpreted to

[2] *Federal Tax Liens,* Plumb, William T., Jr. (1972; 3rd Ed) American Law Institute

mean a purchaser in the ordinary sense. *Enoch* v. *Smith,* 359 F.2d 924, 926 (5th Cir. 1966). In its opinion, the Court of Appeals for the Seventh Circuit correctly stated that your Petitioner did not assert that the assignee was a purchaser, secured party, mechanic's lienor or judgment lien creditor. (Pet. App. A. 3a). See, *United States* v. *Texas Eastern Transmission Corp., supra,* at 254 F. Supp. 119. However, the Court failed to consider the rights of the purchasers from the assignee in what the Court described as his liquidation of the taxpayer's assets. (Pet. App. A. 2a). These persons would fall into the protected category of "purchasers".

The purchasers from the assignee, like all other parties, were unaware of the secret lien which had arisen but had not been asserted or recorded as a matter of public record. While it is true that such purchasers would be aware of the financially troubled condition in Chicagoland Ideel Cleaners, Inc., due to the nature of an assignee's sale, such knowledge does not prevent one from qualifying as a purchaser within the meaning of Section 6323(a). *Marteney* v. *United States, supra,* at 245 F.2d 139; *United States* v. *Von Cseh,* 354 F. Supp. 315 (S.D. Tex. 1972); *United States* v. *Meyer,* 199 F. Supp. 508 (S.D. Ill. 1961). Mere knowledge of financial difficulties does not impute to a prospective purchaser knowledge of the existence of unrecorded tax liens. If the prospective purchaser could not qualify as a Section 6323(a) purchaser due to knowledge of his vendor's financial or possible financial difficulties, then few could so qualify under similar conditions and Section 6323(a) would never apply. Accordingly, the requirement that the Internal Revenue Service record its Notice of Lien to put prospective purchasers on notice of its rights and in doing so, terminate the possibility of said prospective purchasers

of qualifying as Section 6323(a) purchasers would be so weakened as to effectively vitiate the only protection granted to this class. The consequences of such a holding will be to produce increasing numbers of premature bankruptcies due to the inability of troubled businesses to partially liquidate assets in order to gain needed liquidity to continue operations and seek financial rehabilitation.

The Petitioner urges this Court to hold that the purchasers from the assignee were Section 6323(a) purchasers. In so holding, the Court would be amply supported by the purpose of the section and its predecessor in the 1939 Code of protecting purchasers from the Internal Revenue Service's secret lien and giving the purchasers superior rights over an unrecorded tax lien. *United States* v. *Gilbert Associates, Inc., supra*; *Enoch* v. *Smith, supra.* Congress has determined by virtue of its enactment of this section that the rights of a purchaser should be inferior to the federal tax lien only when Notice of Lien has been recorded as a matter of public record prior to the creation of the rights of a purchaser. To hold otherwise, this Court would be seriously weakening the only protection against this secret lien by holding that some indefinite knowledge or suspicion on the part of the purchasers give them cause to believe that an administrative assessment may have been made. The effect of such a decision would be to grant to the Internal Revenue Service a lien superior to the rights of a purchaser for value. In addition, this Court's definition of a purchaser in *Scovil* utilized a vendor-vendee test, in which knowledge of possible federal tax liens would not be present.

In summary, the Petitioner believes that the assignee's purchasers took title to the property of Chicagoland

Ideel Cleaners, Inc., free of the Internal Revenue Service's lien, which was not valid against them due to the failure of the Internal Revenue Service to seasonably record a Notice of Lien before the sale.

Section 6323(a) provides that a federal tax lien is not valid against purchasers, such as are present in the case at bar. The controversy in this case has revolved around the proceeds in the possession of the assignee derived from his sale. The Petitioner believes that an examination of relevant decisional authorities will reveal that the federal tax lien does not attach to the proceeds of the assignee's sale.

As hereinbefore stated, the Internal Revenue Service did not record notice of their secret lien prior to the assignee's sale and therefore suffered the resulting invalidity of its lien. The lien did not attach to the proceeds of the taxpayer's property sold by the assignee for the reason that a lien does not survive a transformation in character of the property with resultant termination of the property interest of the taxpayer. Section 6321 of the Internal Revenue Code of 1954, 26 U.S.C. 6321, provides that a lien arises in favor of the United States upon all "property and rights to property" of the taxpayer. Due to the assignment and sale by the assignee, the proceeds did not constitute the taxpayer's property or right to property.

The determination of the nature and extent of property and rights to property belonging to the taxpayer is a question of state law. *United States* v. *Bess, supra*; *Aquilino* v. *United States,* 363 U.S. 509, 80 S. Ct. 1277, 4 L. Ed. 2d 1365 (1960); *United States* v. *Durham Lumber Co.,* 363 U.S. 522, 80 S. Ct. 1282, 4 L. Ed. 1371 (1960); *City of New York* v. *United States,* 283 F.2d 829 (1960).

It was stated by this Honorable Court in *United States* v. *Bess, supra,* that Section 6323(a)'s predecessor, Section 3672 of the Internal Revenue Code of 1939, creates no property rights but merely attaches consequences, federally defined, to rights created under state law. Therefore, resort must be made to the law of the State of Illinois concerning the property interests, if any, of the taxpayer following the assignment.

In Illinois, a general assignment for the benefit of creditors establishes a trust estate consisting of the assignor's property which is administered by the assignee as Trustee for the benefit of creditors who occupy the position of *cestuis que* trust. *Levy* v. *Chicago National Bank,* 57 Ill. App. 143 (First Dist. 1894), *rev'd. on other grounds*: 158 Ill. 88, 42 N.E. 128, and *Levy* v. *Metropolitan National Bank,* 158 Ill. 258, 42 N.E. 134. The trust so created is an express trust which is capable of supporting an action to enforce its terms by a creditor invoking chancery jurisdiction over trusts. *Howell* v. *Moores,* 127 Ill. 67, 19 N.E. 863 (1889). Upon the assignment, the assignee receives legal and equitable title to all of the assignor's property, whether real or personal, which he holds and administers as Trustee. *Reynolds* v. *Burns,* 20 Ill. 2d 179, 170 N.E. 2d 122 (1961). The transfer of title to the assignee is absolute and there exists no right of reverter or equity of redemption in the assignor. *Weber* v. *Mick,* 131 Ill. 520 (1890); *Browne-Chapin Lumber Co.* v. *Union National Bank of Chicago,* 159 Ill. 458, 42 N.E. 967 (1896). Once made, the assignor is powerless to defeat or weaken the assignment and cannot recover the property or any interest therein. *Taylor* v. *Seiter,* 100 Ill. App. 643 (Fourth Dist. 1901), *affirmed* 199 Ill. 555, 65 N.E. 433. Upon the sale by the assignee as Trustee for the benefit of creditors, the federal tax lien lost its validity and the proceeds passed

into the estate in which the assignor, Chicagoland Ideel Cleaners, Inc. had no right, title or interest. These proceeds could not have been brought into the possession or enjoyment of the assignor and were being held for the benefit of another. Hence, the property interest of Chicagoland Ideel Cleaners, Inc. was extinguished and the federal tax lien upon which the United States relies failed for want of any property to which it could attach. *United States* v. *Bess, supra.*

In *United States* v. *Bess, supra,* the transformation of the assets was similar in substance to the case at bar. *Bess* involved the attempt by the United States to assert against the beneficiary a federal tax lien upon the full proceeds of a life insurance policy for past due income taxes of the decedent. In rejecting the government's position, this Honorable Court stated through Mr. Justice Brennan:

> "It would be anomalous to view as 'property' subject to lien proceeds never within the insured's reach to enjoy, and which are reducible to possession by another only upon the insured's death when his right to change the beneficiary comes to an end. We therefore do not believe that Mr. Bess had 'property' or 'rights to property' in the proceeds, within the meaning of Section 3670, to which the federal tax lien might attach. Cannon v. Nicholas, 10 Cir., 86 F. 2d 934; See United States v. Burgo, 3 Cir., 175 F. 2d 196." (357 U.S. at 55-56).

It is the contention of the Petitioner that just as surely as Mr. Bess lost all property interest in the proceeds[3]

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[3] Applying an analysis of the economic realities, the Court found that the cash surrender value of the policy constituted a fund of paid premiums held for the benefit of the *insured* and was a sufficient property interest upon which the lien could attach.

of the policy of insurance when he passed out of this life, so did Chicagoland Ideel Cleaners, Inc. lose all interest in its assets upon the assignment and sale by the assignee. As assignor, it had irrevocably parted with all interest in and to its assets and had no possibility of recovering the proceeds of the sale. The fund thusly created was held for the benefit of its creditors, and not for the assignor, leaving no property or rights to property belonging to the taxpayer upon which the lien could attach. The subsequent recordation of Notice of Tax Lien and service of Notice of Levy had no effect and did not operate to increase the rights of the Internal Revenue Service. The Notice of Lien only operates to terrminate the rights of purchasers, secured parties, mechanic's lienors and judgment lien creditors who are subject to the lien and obtain their rights after the recordation of the notice. In the same manner, Section 6331 of the Internal Revenue Code of 1954, 26 U.S.C. 6331, provides for a procedure to collect the tax by levying upon taxpayer's property subject to the federal tax lien. The proceeds of the assignee's sale did not constitute the taxpayer's property nor were they subject to the federal tax lien. Thereafter, the petition initiating the bankruptcy proceeding removed the proceeds into the custody of the Bankruptcy Court, providing for that Court's exercise of summary jurisdiction. *Taubel-Scott-Kitzmiller Co.* v. *Fox, supra.*

Confusion concerning the nature of Section 6323(a) has been caused by the decision entitled *United States* v. *Eiland,* 223 F.2d 118 (4th Cir. 1955). The *Eiland* opinion based its holding upon the fact that the indebtedness due the taxpayer which the Internal Revenue Service levied upon constituted intangible personal property and interpreted Section 3672 of the Internal Revenue Code

of 1939, which is substantially similar to the present Section 6323, as applying only to tangible personal property. The Court reasoned that the requirement of filing notice of the federal tax lien as a matter of public record for intangible property could not give any advantage to the general creditors of the taxpayer, hence, its application to an indebtedness would be unreasonable. The Petitioner respectfully suggests that the holding of *Eiland* is erroneous and contrary to the purpose of Section 6323(a), requiring the decision to be overruled or carefully distinguished and restricted to its factual circumstances in order to preserve the protection granted by Congress to general creditors by this provision.

Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), like its predecessor, Section 3672, was intended to give public warning of the secret federal tax lien, so further credit would not be advanced to a taxpayer whose assets were subject to the lien of the United States. *United States* v. *Gilbert Associates, Inc., supra*; *Enoch* v. *Smith, supra.* Tangibles are subject to physical seizure as well as by notice filing, either of which action can constitute the perfection of a lien interest therein. Conversely, intangibles cannot be physically seized in the same sense and for the purpose of perfecting an interest, notice filing is often the only possible method. Consequently, the requirement contained within Section 6323(a) that a federal tax lien be filed as a matter of public record is all the more crucial when dealing with intangibles for it will be the only notice available to interested parties. The rule applied in *Eiland* defeats the purpose of the section and should be corrected by this Court. In excusing the Internal Revenue Service's failure to comply with the notice requirement of Section

3672 by construing service of a Notice of Levy to transfer the debt to the United States, the Fourth Circuit created a rule perhaps technically correct in *Eiland,* but which is clearly erroneous in the instant case. Under the Internal Revenue Code of 1954, the Internal Revenue Service could levy upon the taxpayer's property based on a Section 6321 lien without filing a Notice of Tax Lien, if the rights of persons protected by Section 6323(a) did not intervene between the date of assessment and levy. Section 6331(a), 26 U.S.C. 6331(a). In the case before this Court, the property no longer belonged to the taxpayer when the Notice of Levy was served and the rights of purchasers had intervened. Therefore, the application of *Eiland* to the different factual situations presented in this case should not be condoned by this Court.

This Honorable Court has stated in *United States* v. *Randall, supra,* that the Bankruptcy Act is an overriding statement of federal policy on the question of priorities and rejected the attempt of the United States to improperly utilize the provisions of the Internal Revenue Code in order to create an unwarranted priority. If the United States is allowed to succeed in this instance where it failed in *Randall,* then the erroneous opinion of the Court of Appeals in upholding the federal tax lien will disturb the careful balance established by Congress between the respective interests of the expenses of administration and wage claims, and taxes due to the United States. For this reason, the Court of Appeals for the Ninth Circuit rejected a similar argument advanced by the United States and accepted by the Court of Appeals for the Seventh Circuit. *In Re United General Wood Products Corp., supra.* The Petitioner urges the Court to preserve the vitality of the Bankruptcy Act inviolate from encroachment by the Internal Revenue Code.

Nicholas v. *United States,* 384 U.S. 678, 86 S. Ct. 1674, 16 L. Ed. 2d 853 (1966); *Guarantee Title and Trust Co.* v. *Title Guaranty & Surety Co.,* 224 U.S. 152, 32 S. Ct. 457, 56 L. Ed. 706 (1912); *Davis* v. *Pringle,* 268 U.S. 315, 45 S. Ct. 549, 69 L. Ed. 974 (1925).

II.

THE SERVICE BY THE UNITED STATES OF A NOTICE OF LEVY UPON THE ASSIGNEE DID NOT REDUCE THE PROCEEDS TO THE ACTUAL POSSESSION OF THE UNITED STATES AND ITS LIEN WAS POSTPONED TO THE FIRST AND SECOND PRIORITIES OF SECTION 64 OF THE BANKRUPTCY ACT.

The Petitioner contends that the United States gained no lien upon the proceeds of the assignee's sale and that the proceeds passed into the possession of the Bankruptcy Court as of the date of bankruptcy. Accordingly, the United States would be entitled to a fourth priority among unsecured creditors of the Bankruptcy Act, Section 64, 11 U.S.C. 104. The United States has taken the position that it did have a perfected lien upon the taxpayer's property accompanied by constructive possession due to service of its Notice of Levy upon the assignee. The Petitioner contested and continues to contest the existence and validity of the federal tax lien, but recognizes his obligation to respond to the additional position of the United States with reference to the question of the effect of service of the Notice of Levy. The Petitioner would respectfully reiterate its contention that the federal tax lien was postponed to the first and second priorities established in Section 64 of the Bankruptcy Act, 11 U.S.C. 104, as not being accompanied by actual possession of the taxpayer's personal property. Section 67c(3) of the Bankruptcy Act, 11 U.S.C. 107c(3).

The cornerstone of the argument of the United States seeking to avoid postponement is the case of *United States* v. *Eiland, supra.* The Fourth Circuit in *Eiland* held that the Internal Revenue Service properly asserted its lien through Notice of Levy upon an indebtedness owed to the taxpayer, thereby obtaining constructive possession of the chose in action and avoiding postponement of the federal tax lien to payment of expenses of administration and wage claims.

Eiland determined that the federal tax lien was not postponed for the reason that said section applies only to tangible personal property which can be taken into possession. No authority was cited in the opinion for this proposition, nor did the Court further elaborate on the basis of its conclusion that "personal property" was to be read as "tangible personal property". Justification of this result was attempted by the argument the service of Notice of Levy transferred the chose in action to the United States. However, as with *Eiland's* interpretation of Section 6323, its interpretation of Section 67c of the Bankruptcy Act, 11 U.S.C. 107c, likewise violates the purpose of that statutory provision. The Chandler Act introduced the postponement provisions when not accompanied by possession in order to subordinate statutory liens, including tax liens, to the first and second priorities of Section 64 of the Bankruptcy Act, 11 U.S.C. 104, in the same manner that unsecured claims were subordinated to these priorities. *Goggin* v. *Division of Labor Law Enforcement of California,* 336 U.S. 118, 69 S. Ct. 469, 93 L. Ed. 543 (1949). Congress found that statutory liens, and in particular tax liens, often consumed the entire estate, leaving expenses of administration and priority wage claims unpaid. *Ibid,* 336 U.S. 118, 127, 69 S. Ct. 469, 474, N. 8. The possibility

of this result caused concern on the part of Congress, which favored expenses of administration and priority wage claims over tax claims. H. Rept. 868 on H.R. 136, 89th Cong., 1st Sess. (1965). The House Judiciary Committee stated in its report that "(i)t would be grossly unfair for the bankruptcy court and the attorneys who have labored to wind up the bankrupt's affairs and to accumulate an estate for distribution to receive nothing for his labors". *Ibid,* at 7. The report also commented that "(i)t is also socially desirable that the claims of the wage earner who is normally entirely dependent upon his wages for the necessity of life should be paid to the extent of the restriction in Section 64a(2) before the estate is subject to the heavy burden of all tax liens". *Ibid.* The effect of the ruling of the Court of Appeals will be to deprive wage earners, not only of their limited priority, but of any recovery, contrary to the intent of Congress. If the wage earners are to be paid, their priority must be preserved by this Court. This is their only chance for recovery, whereas the United States has a priority status, and, in addition, maintains the right to assert the personal liability of the officials of the taxpayer, as provided in Section 6672 of the Internal Revenue Code of 1954, 26 U.S.C. 6672. This Court has also expressed its concern for preservation of these priorities and upheld their predominance over a claim for taxes under a trust theory advanced by the United States in *United States* v. *Randall, supra.*

Viewed against the legislative history of the postponement provision, the *Eiland* decision of the Fourth Circuit is an erroneous holding. However, this Court has considered Section 67c in *Goggin* v. *Division of Labor Law Enforcement of California, supra,* and has held

therein that *actual* possession is required to avoid postponement. 336 U.S. 118, 127, 69 S. Ct. 469, 474. Mere service of a Notice of Levy is inadequate to constitute actual possession of the assets in the United States. Notice alone will not give "a public warning of the existence of an enforceable statutory lien for taxes . . ." which is the purpose of Section 67c. *Goggin* v. *Division of Labor Law Enforcement of California,* 336 U.S. 118, 128, 69 S. Ct. 469, 475. See, *City of New York* v. *Hall,* 139 F.2d 935, 936 (2nd Cir. 1944). This conclusion is also supported by one of the leading commentators in the field. *Seligson,* Treatment of Statutory Liens in Bankruptcy — The 1966 Amendments of Section 67b and c, 27 Fed. Bar J. 111, 120-121 (Spring, 1967). The Petitioner urges this Honorable Court to follow its interpretation of Section 67c of the Bankruptcy Act as enunciated in *Goggin* and to reject the decision of the Fourth Circuit in *Eiland,* in order to effectuate the Congressionally determined purpose of protecting innocent third parties from secret tax liens.

In conclusion, the Petitioner submits that even if the Court holds that the United States enjoyed a valid lien, that lien was postponed in payment to the first and second priorities under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, for the reason that service of its Notice of Levy did not reduce the proceeds from the assignee's sale to the actual possession of the United States. Further action was required but was not taken. To hold otherwise would be to exalt fiction over carefully weighed policies. *In Re United General Wood Products Corp., supra.*

III.

THE EXERCISE OF SUMMARY JURISDICTION OF THE BANKRUPTCY COURT WAS PROPER FOR THE REASONS THAT THE BANKRUPTCY COURT OBTAINED CONSTRUCTIVE POSSESSION OF THE PROCEEDS ON THE DATE OF BANKRUPTCY OR, ALTERNATIVELY, ENJOYED SUMMARY JURISDICTION OVER THE ASSIGNEE FOR THE BENEFIT OF CREDITORS WHICH WAS NOT OUSTED BY THE INTERVENTION OF THE UNITED STATES.

The precedent established by the Court of Appeals for the Seventh Circuit in *In Re Chicagoland Ideel Cleaners, Inc., Bankrupt,* was that the Bankruptcy Court lacked jurisdiction, for the reason that the constructive possession of the proceeds of the assignee's sale had passed to the United States, depriving the Bankruptcy Court of possession, and, hence, of summary jurisdiction. As the Petitioner has sought to demonstrate heretofore, the United States did not enjoy a federal tax lien, or, alternatively, the lien was not accompanied by possession and was for that reason postponed in payment to expenses of administration and priority wage claims. If this Court supports either of the Petitioner's positions, summary jurisdiction existed in the Bankruptcy Court. Possession, whether actual or constructive, cannot be simultaneously held by two adverse claimants. In the event this Court holds that possession passed to the Bankruptcy Court as of the date of bankruptcy, then the decision of the Court of Appeals must be reversed and the order of December 9, 1971, of the Bankruptcy Court affirmed.

The Petitioner has previously urged and reiterates to this Court two bases of jurisdiction of the Bankruptcy Court independent of the question of possession of the bankrupt's property to the support that Court's summary

adjudication of the controversy confronting it. Section 2a(21) of the Bankruptcy Act, 11 U.S.C. 11a(21), provides that a representative such as an assignee for the benefit of creditors shall be subject to the jurisdiction of the Bankruptcy Court for the purpose of requiring that representative to turn over the property in his control and possession to the Receiver or Trustee in Bankruptcy. The procedure is summary in nature and designed to eliminate the delay and cost of a plenary proceeding as well as to provide a more effective control over the disbursements of the non-bankruptcy representative. *In Re John M. Russell, Inc.*, 318 U.S. 515, 63 S. Ct. 687, 87 L. Ed. 954 (1943). Similarly, Section 70a(8) of the Bankruptcy Act, 11 U.S.C. 110a(8), expressly provided for the exercise of summary jurisdiction over property held by an assignee for the benefit of creditors appointed under a general assignment.

The original proceedings before the Bankruptcy Court consisted of an application by your Petitioner for a turn over order against the assignee. (A. 9). Clearly, this was a summary proceeding. The assignee failed to answer the application but the United States did respond to it (A. 10). An answer by one not a party to a proceeding must be considered as an intervention into the existing proceeding. *Phelps* v. *Oaks,* 117 U.S. 236, 6 S. Ct. 714, 29 L. Ed. 888 (1886). Intervention cannot alter the nature of the pre-existing proceedings, *Vinson* v. *Washington Gas, Light Co.,* 321 U.S. 489, 64 S. Ct. 731, 88 L. Ed. 883 (1944), nor oust jurisdiction of the Court once properly invoked. *Mitchell* v. *Maurer,* 293 U.S. 237, 55 S. Ct. 162, 79 L. Ed. 338 (1934).

It would be anomalous, indeed, to allow the United States to intervene into a special and summary proceeding for the purpose of challenging the jurisdiction

of the Bankruptcy Court to hear and adjudicate the proceeding into which the United States intervened. The proper procedure that the United States ought to have followed would have been to diligently reduce the assets to its physical possession prior to the assignee's sale in which case it would have been entitled to a plenary proceeding, or to stand on its alleged rights outside of the bankruptcy proceeding, relying upon the possibility of a penalty under Section 6332(c) and a discharge under Section 6332(d) of the Internal Revenue Code of 1954, 26 U.S.C. 6332(c) and (d), to compel the assignee to deliver the proceeds to the Internal Revenue Service. In the latter instance, a plenary action would again be required. Failing to take either course, but following a period of somnolence in the assertion of its claimed rights with a course of action situated half way between the two permissible alternatives, it has created a jurisdictional confusion which clouds the vital issues erroneously adjudicated in this case by the Court of Appeals.

CONCLUSION

Based upon the foregoing, the Petitioner respectfully urges this Honorable Court to reverse the judgment of the United States Court of Appeals for the Seventh Circuit and to uphold the order of the Bankruptcy Court.

Respectfully submitted,

KEVIN J. GILLOGLY
One North LaSalle Street
Chicago, Illinois 60602
Attorney for Petitioner

DANIEL C. AHERN
DENNIS E. QUAID
Of Counsel

APPENDIX

"Bankruptcy Act, 11 U.S.C. 1, et seq."

Section 2a. CREATION OF COURTS OF BANKRUPTCY AND THEIR JURISDICTION. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

(21) Require receivers or trustees appointed in proceedings not under this Act, assignees for the benefit of creditors, and agents authorized to take possession of or to liquidate a person's property to deliver the property in their possession or under their control to the receiver or trustee appointed under this Act or, where an arrangement or plan under this Act has been confirmed and such property has not prior thereto been delivered to a receiver or trustee appointed under this Act, to deliver such property to the debtor or other person entitled to such property according to the provisions of the arrangement or plan, and in all such cases to account to the court for the disposition by them of the property of such bankrupt or debtor: *Provided, however,* That such delivery and accounting shall not be required except in proceedings under section 77 and chapters X and XII of this Act, if the receiver or trustee was appointed, the assignment was made, or the

agent was authorized more than four months prior to the date of bankruptcy. Upon such accounting, the court shall reexamine and determine the propriety and reasonableness of all disbursements made out of such property by such receiver, trustee, assignee, or agent, either to himself or to others, for services and expenses under such receivership, trusteeship, assignment, or agency, and shall, unless such disbursements have been approved, upon notice to creditors and other parties in interest, by a court of competent jurisdiction prior to the proceeding under this Act, surcharge such receiver, trustee, assignee, or agent the amount of any disbursement determined by the court to have been improper or excessive; and ...

Section 64a. DEBTS WHICH HAVE PRIORITY. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of title 18 of the United States Code, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter

provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding, including expenses necessarily incurred by a debtor in possesion, receiver, or trustee in preparing the schedule and statement required to be filed by sections 238, 378, or 483, shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesmen" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the

bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18 of the United States Code, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy: *Provided, however,* That no priority over general unsecured claims shall pertain to taxes not included in the foregoing priority; *And provided further,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; and (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by paragraph (2) of subdivision c of Section 67 of this Act: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

Section 67c(3). Every tax lien on personal property not accompanied by possession shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act. Where such tax lien is prior in right to liens indefeasible in bankruptcy, the court shall order payment from the proceeds derived from

the sale of the personal property to which the tax lien attaches, less the actual cost of that sale, of an amount not in excess of the tax lien, to the debts specified in clauses (1) and (2) of subdivision a of Section 64 of this Act. If the amount realized from the sale exceeds the total of such debts, after allowing for prior indefeasible liens and the cost of the sale, the excess up to the amount of the difference between the total paid to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and the amount of the tax lien, is to be paid to the holder of the tax lien.

Section 70a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located ... (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy, which property shall, for the purposes of this Act, be deemed to be held by the assignee as the agent of the bankrupt and shall be subject to the summary jurisdiction of the court.

"Internal Revenue Code of 1954, 26 U.S.C."

Section 6321. Lien for taxes

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether

real or personal, belonging to such person. Aug. 16, 1954, c. 736, 68 A Stat. 779.

Section 6322. Period of lien

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time. Aug. 16, 1954, c. 736, 68A Stat. 779; Nov. 2, 1966, Pub. L. 89-719, Title I, §113(a), 80 Stat. 1146.

Section 6323. Validity and priority against certain persons.

(a) Purchases[1], holders of security interests, mechanic's lienors, and judgment lien creditors. — The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate.

(f) Place for filing notice; form.—

(1) Place for filing.—The notice referred to in subsection (a) shall be filed—

(A) Under State laws.—

(i) Real property.—In the case of real property, in one office within the State (or the county, or other governmental subdivision), as designated by the laws of such State, in which the property subject to the lien is situated; and

(ii) Personal property.—In the case of personal property, whether tangible or intangible, in one office within the State (or the county, or other governmental

subdivision), as designated by the laws of such State, in which the property subject to the lien is situated; or

(B) With clerk of district court.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State has not by law designated one office which meets the requirements of subparagraph (A); or

(C) With Recorder of Deeds of the District of Columbia.—In the office of the Recorder of Deeds of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(2) Situs of property subject to lien.—For purposes of paragraph (1), property shall be deemed to tbe situated—

(A) Real property.—In the case of real property, at its physical location; or

(B) Personal property.—In the case of personal property, whether tangible or intangible, at the residence of the taxpayer at the time the notice of lien is filed.

For purposes of paragraph (2) (B), the residence of a corporation or partnership shall be deemed to be the place at which the principal executive office of the business is located, and the residence of a taxpayer whose residence is without the United States shall be deemed to be in the District of Columbia.

(3) Form.—The form and content of the notice referred to in subsection (a) shall be prescribed by the Secretary or his delegate. Such notice shall be valid notwithstanding any other provision of law regarding the form or content of a notice of lien.

Section 6331. Levy and distraint

(a) Authority of Secretary or delegate—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax.

Section 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully accouunt for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable. Aug. 16, 1954, c. 736, 68 A Stat. 828.

Supreme Court, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1974

CRAIG PHELPS, RECEIVER IN BANKRUPTCY IN THE MATTER OF CHICAGOLAND IDEEL CLEANERS, INC., BANKRUPT, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

ROBERT H. BORK,
Solicitor General,
SCOTT P. CRAMPTON,
Assistant Attorney General,
KEITH A. JONES,
Assistant to the Solicitor General,
CROMBIE J. D. GARRETT,
KARL SCHMEIDLER,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

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In the Supreme Court of the United States

OCTOBER TERM, 1974

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v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The orders of the bankruptcy court (A. 15–16) and of the district court (A. 19–20) are not officially reported. The opinion of the court of appeals (Pet. App. A) is reported at 495 F. 2d 1283.

JURISDICTION

The judgment of the court of appeals (Pet. App. B) was entered on May 7, 1974. A timely petition for rehearing was denied on May 24, 1974 (A. 22). The petition for a writ of certiorari was filed on August 14,

1974, and was granted on December 16, 1974. The jurisdiction of this Court rests upon 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the United States, by serving the taxpayer's general assignee with a valid notice of levy, took custody of all property in the assignee's possession on which there was a federal tax lien.

2. Whether the government's claims to property that it levied upon prior to bankruptcy may be adjudicated by the bankruptcy court in a summary proceeding.

STATUTES AND REGULATION INVOLVED

The pertinent provisions of Sections 2a(21) and 67c(3) of the Bankruptcy Act, as amended, 11 U.S.C. 11(a)(21) and 107(c)(3), and Sections 6321, 6322, 6323, 6331, and 6672 of the Internal Revenue Code of 1954, as amended, 26 U.S.C. 6321, 6322, 6323, 6331, and 6672, are set forth in the appendix to petitioner's brief.

The pertinent provisions of Section 6332 of the Internal Revenue Code of 1954, 26 U.S.C. 6332, and of Section 301.6331–1(a)(1) of the Treasury Regulations on Procedure and Administration, 26 C.F.R. 301.6331–1(a)(1), are set forth at pp. 2–3 of the United States' memorandum in response to the petition for a writ of certiorari.

STATEMENT

Between March 12, 1971, and June 4, 1971, the Internal Revenue Service made assessments against

Chicagoland Ideel Cleaners, Inc., of federal income and social security withholding taxes and federal unemployment taxes, for the period from July 1, 1970, to March 31, 1971, in the total amount of $140,831.59 (see App. 13). Chicagoland failed to pay these taxes after formal demand for payment. Instead, on June 28, 1971, Chicagoland assigned all its property to an individual, Nathan Yorke, as assignee for the benefit of its creditors (App. 5–8). Yorke liquidated the property and held the proceeds (App. 9).[1]

On August 25, 1971, the Service filed a notice of its tax lien for the taxes previously assessed, served Yorke with a notice of levy, and demanded payment. The notice of tax lien stated that $140,831.59 in taxes had been assessed against Chicagoland and that "after demand for payment thereof [the taxes] remained unpaid" (App. 13). The notice of levy informed petitioner that (App. 14):

> * * * demand has been made for the amount set forth herein upon the taxpayer who has neglected or refused to pay * * *. Accordingly, * * * all property, rights to property, moneys, credits and bank deposits now in your possession and belonging to this taxpayer (or with respect to which you are obligated) and all sums of money or other obligations owing from you to this taxpayer, or on which there is a [federal tax] lien * * * are hereby levied upon and seized for satisfaction of the aforesaid tax * * *,

[1] We have been informed by the referee in bankruptcy that the proceeds, including accumulated interest, now amount to approximately $38,000, and by petitioner's counsel that on the date of levy Yorke was holding them in a bank account pending distribution to creditors.

> and demand is hereby made upon you for the amount necessary to satisfy the liability set forth herein, or for such lesser sum as you may be indebted to him * * *.

On September 14, 1971, an involuntary petition in bankruptcy was filed against Chicagoland. Petitioner was appointed receiver in bankruptcy, and Chicagoland was adjudicated bankrupt. Petitioner then filed an application with the referee in bankruptcy for an order requiring the assignee, Yorke, who had not yet complied with the Service's demand for payment, to turn over to petitioner the proceeds from the sale of Chicagoland's assets (App. 9–10). Despite the objection of the United States that the bankruptcy court lacked jurisdiction (App. 10–11), the referee ordered the proceeds turned over to petitioner (App. 15–16). The district court affirmed (Pet. App. C; App. 19–20). The court of appeals reversed (Pet. App. A), holding that the levy had transferred possessory interest in the proceeds to the United States and, therefore, that the bankruptcy court lacked summary jurisdiction to order the proceeds paid over to petitioner.

SUMMARY OF ARGUMENT

I

A. Under Section 6331(a) of the Internal Revenue Code, the United States may proceed administratively by levy to collect unpaid federal tax liabilities. The levy power extends to, *inter alia,* all property and rights to property, including intangible property, on which there is a lien arising on account of the taxpayer's liability.

A valid levy on intangible property held by a third person is effected by serving that person with a formal notice of levy. See, *e.g., Sims* v. *United States,* 359 U.S. 108, 110–111. The effect of the notice of levy is to designate the person served as the government's custodian with respect to the property subject to levy.

These general principles are not controverted by petitioner. It is therefore clear that the service of notice of levy upon the taxpayer's assignee in this case made the assignee the government's custodian with respect to all intangible property in his possession on which there was a lien arising on account of the taxpayer's liability.

B. Petitioner contends, however, that at the time of the service of notice of levy here, the taxpayer's general assignee was not holding any property on which there was a levy. This contention borders on the frivolous.

Petitioner concedes, as he must, that the assignee took the taxpayer's property subject to the government's lien. But it is also clear that when the assignee subsequently sold or liquidated that property, the government's lien attached to the proceeds in substitution. It has anciently been the case, under controlling federal common law, that "the lien re-attaches * * * to whatever is substituted for [the property to which the lien originally attached]." *Sheppard* v. *Taylor,* 5 Pet. 675, 710. And this Court has expressly held, with limitations not here relevant, that a federal tax lien attaches to proceeds received by a transferee in substitution for the taxpayer's original property. *United*

States v. *Bess*, 357 U.S. 51. The same result would follow under Illinois law.

Accordingly, the proceeds held by the assignee remained subject to levy as intangible property on which there was a lien, and the service of the notice of levy had the effect of placing those proceeds in the custody of the United States. See *N.H. Fire Ins. Co.* v. *Scanlon*, 362 U.S. 404.

II

A. A third person's substantial claims to property in its actual or constructive possession may not be adjudicated by the bankruptcy court in a summary proceeding; the bankruptcy court lacks jurisdiction summarily to order such property turned over to the receiver for administration as part of the bankrupt estate. See generally Collier, *Bankruptcy*, paras. 23.04 and 23.10 (14th ed.). To reach such property, the receiver must institute a plenary suit under Section 23 of the Bankruptcy Act. Petitioner does not appear to contest these general principles.

The application of these principles to this case is, in our view, a straightforward matter: the government's levy established a custodial relationship between the assignee and the United States and thereby reduced the proceeds to the United States' constructive possession; accordingly, the proceeds are not subject to summary turnover. Following the levy, actual possession of the proceeds was held by the assignee on behalf of the United States, and "where possession is assertedly held not for the bankrupt, but for others prior to bankruptcy * * *, the holder is

not subject to summary jurisdiction." 2 Collier, *supra*, para. 23.06[3].

This result serves the government's legitimate interest in orderly tax collection. If the government could not rely upon its levy upon intangible property as conferring constructive possession for Bankruptcy Act purposes, it would be forced to engage in an unseemly scramble for actual possession of such property whenever the taxpayer was believed to be in precarious financial circumstances. That process might entail considerable disruption and inconvenience for taxpayers and third parties subject to levy. Moreover, it is by no means clear how some forms of intangible property, such as, for example, accounts receivable and causes of action, could be quickly reduced to actual possession. Accordingly, for practical reasons of internal revenue collection, as well as for established reasons of bankruptcy law, the government should be able to rely upon a valid prebankruptcy levy as removing the intangible property subject to levy from the reach of summary turnover orders.

B. This result is not changed by the provisions of the Bankruptcy Act upon which petitioner relies.

Section 67c(3) of that Act has no bearing on the question of summary jurisdiction; it relates only to the priority that is to be accorded tax liens on property that has already been determined to be within the court's jurisdiction as part of the bankrupt estate. Moreover, it is addressed only to the question of the priority of tax *liens*, not to the effect of tax *levies*.

Sections 2a(21) and 70a(8) of the Bankruptcy Act grant the bankruptcy court power to order turnover only of property held by a general assignee in his capacity as "mere naked bailee for the creditors * * *." *In re McCrum,* 214 Fed. 207, 209 (C.A. 2). Property held by an assignee after an effective levy, in his capacity as the government's agent or custodian, is not subject to summary turnover under those provisions.

C. Accordingly, under long accepted bankruptcy principles, the United States, as an adverse claimant in constructive possession, is entitled to have its claims adjudicated in a plenary proceeding. This conclusion is further bolstered by two nonbankruptcy considerations.

First, the government's possessory claims generally are not subject to summary adjudication, and this is especially the case with regard to "[p]roperty seized by a revenue officer for delinquent taxes * * *." *N.H. Fire Ins. Co.* v. *Scanlon, supra,* 362 U.S. at 408.

Second, petitioner's suit for summary turnover is designed to prevent the assignee from fulfilling his statutory obligation of surrendering property to the United States pursuant to a levy and is therefore barred by Section 7421 of the Internal Revenue Code, which provides that "no suit for the purpose of restraining the * * * collection of any tax shall be maintained in any court by any person * * *."

ARGUMENT

I

BY SERVING THE TAXPAYER'S GENERAL ASSIGNEE WITH A VALID NOTICE OF LEVY, THE UNITED STATES TOOK CUSTODY OF ALL PROPERTY IN THE ASSIGNEE'S POSSESSION ON WHICH THERE WAS A FEDERAL TAX LIEN

A. A NOTICE OF LEVY PLACES THE INTANGIBLE PROPERTY SUBJECT TO LEVY IN THE CUSTODY OF THE UNITED STATES

In situations where a tax liability remains unpaid after the filing of a return, or where no return has been filed, the formal process of internal revenue collection begins with the "assessment" of tax pursuant to Section 6201 of the Internal Revenue Code of 1954, 26 U.S.C. 6201. The assessment is an administrative determination of the amount of the taxpayer's outstanding unpaid tax liability. Within 60 days of the making of the assessment, the taxpayer is notified of the amount of his unpaid tax liability, and demand for payment is made. See Section 6303 of the Internal Revenue Code.

If the taxpayer neglects or refuses to pay the tax after demand, the amount of the tax, together with interest and penalties, "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to [the taxpayer]." Section 6321 of the Code. The tax lien

relates back to the date of assessment (Section 6322 of the Code), and it attaches to after-acquired property. *Glass City Bank* v. *United States*, 326 U.S. 265. The lien is valid *ab initio* as against the taxpayer's unsecured creditors, and also as against transferees who do not furnish full and fresh consideration. See *United States* v. *City of New Britain*, 347 U.S. 81, 88 (noting that Congress intended federal tax liens to rank ahead of all interests not specifically protected by statute); Section 6323(h)(6) of the Code (providing that the only purchasers protected against unfiled tax liens are those who furnish "adequate and full consideration in money or money's worth"); *Filipowicz* v. *Rothensies*, 43 F. Supp. 619 (E.D. Pa.) (holding that assignees for past due consideration take subject to an unfiled tax lien). Once a notice of lien is filed pursuant to Section 6323(f) of the Code, the lien is also valid as against subsequent purchasers, holders of security interests, mechanic's lienors, and judgment lien creditors. See Section 6323(a) of the Code; *United States* v. *Leventhal*, 316 F. 2d 341 (C.A.D.C.); *Bank of Nevada* v. *United States*, 251 F. 2d 820 (C.A. 9).

If after assessment and demand the taxpayer's liability remains unpaid, the government may proceed administratively to collect the tax by levy.[2] See Section 6331 of the Code. This "right of the United

[2] The United States is not, of course, limited to administrative collection procedures. For example, the government could bring a civil action in federal district court to enforce its tax lien. See Section 7403 of the Code. But we are concerned here only with the scope and effect of the administrative remedy.

States to collect its internal revenue by summary administrative proceedings has long been settled." *Phillips* v. *Commissioner*, 283 U.S. 589, 595. See also *Springer* v. *United States*, 102 U.S. 586, 593–594; *Murray's Lessee* v. *Hoboken Land and Improvement Co.*, 18 How. 272, 277–278.

The levy power extends to two broad overlapping categories of property—(1) "all property and rights to property * * * belonging to [the taxpayer]" (Section 6331(a) of the Code) and (2) all property and rights to property "on which there is a lien" (*ibid.*). In almost all circumstances, except where the tax lien has been released pursuant to Section 6325 of the Code, the property belonging to the taxpayer will also be property "on which there is a lien." See Section 6321 of the Code; *Glass City Bank* v. *United States*, *supra*. The converse, however, is not true, for there may be many instances in which property "on which there is a lien" no longer belongs to the taxpayer. For example, a donative conveyance that is effective under state law to transfer legal and equitable title from the taxpayer to the donee nevertheless does not free the property from a pre-existing federal tax lien. See, *e.g.*, *United States* v. *Mitchell*, 413 F. 2d 181 (C.A. 7). Such property therefore remains subject to levy under Section 6331 of the Code.

Both tangible and intangible property are subject to levy. Section 6331(b) of the Code makes this explicit by providing that the government may, in the exercise of its levy power, "seize and sell * * * property or rights to property (whether real or personal,

tangible or intangible)." And this Court has frequently sustained levies on intangible property. See, *e.g., Sims* v. *United States,* 359 U.S. 108, 110–111.

Levy upon tangible property normally is effected by service of a Levy (Form 668–B) or Notice of Levy (Form 668–A) and physical seizure of the property.[3] Where physical seizure is not feasible, the property is posted or tagged in a manner that indicates that it has been taken into the government's custody. Since intangible property is not susceptible to physical seizure, posting, or tagging, levy upon intangible property is effected by serving the appropriate form upon the person holding the property or rights to property: "[l]evy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy including receivables, bank accounts, evidences of debt, securities, and accrued salaries, wages, commissions, and other compensation." Section 301.6331–1(a)(1) of the Treasury Regulations on Procedure and Administration, 26 C.F.R. 301.6331–1(a)(1).

The standard notice of levy, which was served upon the assignee in this case, notifies the person served that "all property, rights to property, moneys, credits, and bank deposits now in your possession and belonging to this taxpayer * * * and all sums of money or other obligations owing from you to this taxpayer, or

[3] The Levy is served upon the taxpayer; the Notice of Levy is served upon third persons. When service is made upon a third person, a copy of the Notice of Levy is furnished to the taxpayer.

on which there is a lien * * * are hereby levied upon and seized" (App. 14). A formal demand for payment is printed on the notice (*ibid.*).

Service of notice of levy, accompanied by demand, effects a valid levy upon intangible property. See, *e.g., Sims* v. *United States, supra.* Such a levy reaches (1) all the taxpayer's intangible property in the hands of the person served, including any debts he owes to the taxpayer, and (2) any property that that person holds in his possession on which there is a lien arising on account of the taxpayer's liability. See Section 6331(a) of the Code.

Following levy and demand, the property levied upon "belongs", in a very real sense, to the United States. The person holding actual possession of the property does so as the government's agent, custodian, or bailee. If that person fails or refuses after demand to surrender the property subject to levy, he becomes personally liable to the United States for "a sum equal to the value of the property or rights not so surrendered." Section 6332(c)(1) of the Code. Thus service of a standard notice of levy, which includes a demand for surrender of the property, is tantamount to a transfer of ownership of the intangible property levied upon to the United States: the levy places the intangible property in custody for the benefit of the United States. See *N.H. Fire Ins. Co.* v. *Scanlon,* 362 U.S. 404. See also *United States* v. *Pittman,* 449 F. 2d 623 (C.A. 7); *In re Cherry Valley Homes, Inc.,* 255 F. 2d 706 (C.A. 3), certiorari denied *sub nom. DuBois, Trustee* v. *United States,* 358 U.S. 864; *United States* v. *Eiland,* 223 F. 2d 118 (C.A. 4).

B. THE PROPERTY HERE AT ISSUE WAS SUBJECT TO LEVY

Under the principles set forth above (pp. 9–13, *supra*), the service of the notice of levy upon the assignee, Yorke, effected a valid levy upon, and transferred to the government's custody, all property in Yorke's possession on which there was a lien arising on account of the taxpayer's tax liability.[4] Petitioner does not directly contest this point. He argues (Br. 8–13) instead that the government's lien did not attach to the proceeds received by Yorke from the sale of the assigned property and therefore that at the time of levy Yorke held no property "on which there [was] a lien." Section 6331(a) of the Code.[5] That argument, we believe, borders on the frivolous. It is clear under both federal and Illinois law that a lien attaches to the proceeds from the sale of encumbered property and that, in particular, the government's lien here attached to the proceeds derived from Yorke's sale of the assigned property.

[4] The levy also reached all property of the taxpayer then in Yorke's possession, including any debt that he owed to the taxpayer. However, petitioner contends (Br. 13–16) that under Illinois law the assignment vested legal and equitable title to the assigned property in Yorke as trustee for the benefit of creditors and therefore that Yorke held no property of, and owed no debt to, the taxpayer. We do not here contest petitioner's reading of Illinois law on these matters.

[5] Much of petitioner's discussion on this point is in support of the proposition, which we do not challenge, that the government's unfiled lien would not follow the assigned property into the hands of good faith purchasers from the assignee. But the government is not attempting to reach the property in the hands of those purchasers. The government's claim is to the proceeds in the hands of the assignee.

1. Yorke took the assigned property subject to the government's lien

Tax assessments were made against Chicagoland between March 12, 1971, and June 4, 1971. The government's lien attached to Chicagoland's property at the time those assessments were made. Chicagoland assigned all its property to Yorke on June 28, 1971. It is undisputed that Yorke took the property subject to the government's lien.[6]

If the assigned property remained in Yorke's hands on August 25, 1971, the date on which the government filed its notice of lien and served Yorke with a notice of levy, there could be no doubt that that property was subject to levy as property "on which there [was] a lien." Section 6331(a) of the Code. Petitioner asserts (Br. 10), however, that Yorke had sold or otherwise liquidated the assigned property before August 25, 1971, and that on that date Yorke was holding only the proceeds of that liquidation. See note 2, *supra*. Although the record sheds no light on that matter, we are willing to accept petitioner's assertion as factually correct.

[6] On the date of assignment, the government's unfiled tax lien was effective as against all third persons other than purchasers, holders of secured interests, mechanic's lienors, and judgment lien creditors. See p. 10, *supra*. Petitioner correctly concedes (Br. 11) that Yorke did not fall within any of those categories. Under Illinois law, a general assignee is not a purchaser but rather an agent for the distribution of the assignor's property, which he takes subject to all outstanding liens. See, *e.g.*, *Sanner* v. *Sanner*, 257 Ill. App. 305; *Columbia Hardwood Lumber Co.* v. *Brandenberger*, 82 Ill. App. 327; *Home Savings and State Bank* v. *Wheeler*, 74 Ill. App. 261.

2. The lien attached to the proceeds in substitution

State law controls the question whether a taxpayer has a property right subject to lien under Section 6321 of the Code. See, *e.g., Aquilino* v. *United States,* 363 U.S. 509. But once it has been established that a lien exists, federal law controls the question whether the lien remains effective upon a transfer or substitution of the property subject to lien. See *United States* v. *Bess,* 357 U.S. 51. And it is clear, under federal law, that the government's lien in this case remained effective upon the substitution of the proceeds for the property in the hands of the assignee.

Indeed, one of the most ancient doctrines of federal common law is that a lien attaches to the proceeds from the sale of the property subject to the lien. As Justice Story stated in *Sheppard* v. *Taylor,* 5 Pet. 675, 710:

> * * * the lien re-attaches to the thing and to whatever is substituted for it. This is no peculiar principle of the admiralty. It is found incorporated into the doctrines of courts of common law and equity. The owner and the lienholder, whose claims have been wrongfully displaced, may follow the proceeds, wherever they can distinctly trace them.

We know of no contrary authority. Accordingly, since Yorke, the assignee here, sold property that was subject to the government's lien in his hands, the lien attached to the proceeds.[7]

[7] In making this contention, we do not rely upon any property right that Chicagoland may have retained in the proceeds. Of course, if the proceeds were property of Chicagoland under state law, a lien would automatically attach under Section 6321 of the Code. See *Glass City Bank* v. *United States, supra.*

In contesting this point, petitioner relies (Br. 15), apparently exclusively, upon *United States* v. *Bess, supra.* But *Bess* in fact supports our position. In that case, this Court held that the tax lien on an insured-taxpayer's policy of life insurance follows and attaches to the insurance proceeds in the hands of the beneficiary, to the extent of the cash surrender value of the policy in the taxpayer's hands prior to death. In short, subject to the limitation that the lien does not attach to an element of value not realizable by the taxpayer, under federal law the government's lien attaches to proceeds received by a transferee in substitution for the taxpayer's original property.

Petitioner would fare no better under Illinois law. Illinois law has long provided that where an assignee takes property subject to a lien, the lien attaches to the proceeds from the assignee's sale of that property. See, *e.g., Black* v. *Palmer,* 15 Ill. App. 2d 207, 145 N.E. 2d 797; *Loeber* v. *Leininger,* 175 Ill. 484, 51 N.E. 703; *Hooven* v. *Burdette,* 153 Ill. 672, 39 N.E. 1107.

The reason for this generally accepted rule of common law is, of course, not difficult to perceive. Any other rule would permit transferees to defeat a lien by the simple, if unscrupulous, expedient of selling or exchanging the property; the interest of the lienholder in preserving his security is entitled to greater protection than that. The rule petitioner suggests, as applied in the context of internal revenue collection, would permit a taxpayer to evade a lien by transferring his property to a donee who, although taking subject to the lien (see p. 11, *supra*), could then sell the property and retain the proceeds free of lien. Such a

result would serve no legitimate purpose and would improperly interfere with efforts at tax collection.

To summarize, since Yorke took Chicagoland's property subject to the government's lien, the lien attached to the proceeds from the sale of that property in Yorke's hands; as property "on which there [was] a lien" (Section 6331(a) of the Code), the proceeds were subject to levy by service of notice of levy upon Yorke.

II

THE GOVERNMENT'S CLAIMS TO PROPERTY THAT IT LEVIED UPON PRIOR TO BANKRUPTCY MAY NOT BE ADJUDICATED BY THE BANKRUPTCY COURT IN A SUMMARY PROCEEDING

We have shown above (pp. 9–18, *supra*) that prior to the bankruptcy of the taxpayer, Chicagoland, the United States had, by levy, taken custody of the proceeds being held by Chicagoland's assignee. Our further contention here is that the United States is entitled as against petitioner, the receiver in bankruptcy, to retain custody and control of those proceeds, and to take any necessary additional steps to reduce them to its actual possession, unless and until petitioner establishes in a plenary judicial proceeding that the government's underlying tax claim is itself invalid.[8] In short, we contend that property levied upon by the government prior to bankruptcy may not be ordered

[8] Neither the taxpayer nor petitioner has challenged the validity of the government's tax claim.

turned over to the receiver by the bankruptcy court in a summary proceeding.

The difference between a summary and plenary proceeding in this context is not merely a matter of the relative formality of the respective procedures. The consequence of a summary turnover order is to subject the property in question to administration as part of the bankrupt estate. Where the government has a tax lien on the property, the consequence of the turnover is to subordinate that lien to the expenses of administration and priority wage claims. See Section 67c(3) of the Bankruptcy Act, 11 U.S.C. 107(c)(3). In contrast, if the property is not subject to summary turnover, it may be brought into the bankrupt estate only if the receiver is able to defeat the government's underlying tax claim in a plenary proceeding, *i.e.*, a suit for refund. Thus, in a case where the underlying tax claim is sound, for the government the difference between a summary and a plenary proceeding is the difference between holding the property subject to prior payment of administrative and priority wage claims and holding it outright.

It is undisputed that where the government has only a bare lien, without the constructive possession conferred by levy, the encumbered property is subject to summary turnover. But we now show that where the government additionally has levied upon the property prior to bankruptcy, the property cannot be summarily ordered turned over to the receiver for administration as part of the bankrupt estate.

A. AS A GENERAL RULE, A THIRD PERSON'S CLAIMS TO PROPERTY IN ITS ACTUAL OR CONSTRUCTIVE POSSESSION MAY NOT BE ADJUDICATED IN A SUMMARY PROCEEDING

This case arises from petitioner's request that the bankruptcy court order that the property levied upon by the government prior to bankruptcy be turned over to petitioner for administration as assets of the bankrupt estate. By that request, petitioner sought to invoke the bankruptcy court's summary jurisdiction; "[i]n order to secure a turnover order, the receiver or trustee must first of all establish the summary jurisdiction of the court, except where the defendant consents." 2 Collier, *Bankruptcy*, para. 23.10 [2] (14th ed.).

The general principles governing the scope of a bankruptcy court's summary jurisdiction have been correctly stated as follows (2 Collier, *supra*, para. 23.04[2]):

> Generally speaking, where the controversy is one concerning property in the actual or constructive possession of the bankruptcy court, that court may adjudicate summarily all rights and claims pertaining thereto. Where the controversy is one involving property in the actual or constructive possession of a third person asserting a *bona fide* adverse claim, the bankruptcy court has no jurisdiction to determine summarily that person's claim upon petition by the receiver or trustee, unless by that person's consent. Without the consent of the adverse claimant, a plenary suit must be

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> brought in the court of appropriate jurisdiction * * *.[9]

These principles have been repeatedly applied to bar summary turnover of property in the actual or constructive possession of an adverse claimant; to reach such property, the receiver or trustee must institute a plenary suit under Section 23 of the Bankruptcy Act, in which the respective rights of the contending claimants may be determined. See, *e.g.*, *Taubel, Etc., Co.* v. *Fox*, 264 U.S. 426, 433–434; *Thompson* v. *Magnolia Co.*, 309 U.S. 478; *Cline* v. *Kaplan*, 323 U.S. 97, 98–99; *United States* v. *Owens*, 329 F. 2d 678, 680 (C.A. 5); *In re American National Trust*, 426 F. 2d 1059 (C.A. 7). In short, property in the actual or constructive possession of a third person who asserts a *bona fide* adverse claim is not subject to turnover, and such an adverse claimant is entitled to have his claims adjudicated in a plenary action. See, generally, 2

[9] Petitioner apparently contends (Br. 7, 24–25) that the United States' intervention as an adverse claimant in the bankruptcy court's proceeding constituted an acquiescence in the exercise of summary jurisdiction. However, the United States' answer to petitioner's application for summary turnover expressly stated that "[t]his court of bankruptcy lacks jurisdiction over the subject matter of the application" (App. 10) and that "the United States has not and does not consent to the adjudication of the controversy" (App. 11). As an adverse claimant in constructive possession of the proceeds, the United States was entitled to refuse to consent to a summary adjudication, and it stated its refusal in a clear and timely fashion. There was no acquiescence in the exercise of summary jurisdiction.

Collier, *supra*, para. 23.06. We do not understand petitioner to contest these general principles, which are, in any event, well established.

The application of these principles to this case is, in our view, a straightforward matter: the government's levy upon the proceeds in the hands of the assignee established a custodial relationship between the assignee and the United States (see pp. 9–18, *supra*) and thereby reduced the proceeds to the United States' constructive possession; accordingly, the proceeds are not subject to turnover; instead, the United States, as an adverse claimant to proceeds in its constructive possession, is entitled to have its claims adjudicated in a plenary action. *Rosenblum* v. *United States*, 300 F. 2d 843 (C.A. 1); *United States* v. *Eiland*, *supra*. Cf. *United States* v. *Pittman*, *supra*; *In re Brewster-Raymond Co.*, 344 F. 2d 903 (C.A. 6).

The Ninth Circuit reached a contrary result in *In re United General Wood Products Corp.*, 483 F. 2d 975. The court held that where the person in actual possession of the property (in this case, the assignee, Yorke) was not himself an adverse claimant, the bankruptcy court has summary jurisdiction to order the property turned over to the receiver. But the court rested that result upon the erroneous assumption that "[c]laims of third persons [in this case, the United States] to the same asset are irrelevant to the jurisdictional issue." 483 F. 2d at 976. In other words, the court implicity proceeded on the erroneous theory that in order to avoid a turnover order, the adverse claimant must have actual, and not merely constructive,

possession. The law is clearly to the contrary (2 Collier, *supra*, para. 23.06[3]; footnotes omitted):

> Where a third person holds possession of the bankrupt's property, and makes no adverse claim to it, that person will be subject to summary jurisdiction even though others make claims adverse to the bankrupt. But where possession is assertedly held not for the bankrupt, but for others prior to bankruptcy * * *, the holder is not subject to summary jurisdiction.

See, *e.g.*, *First Nat. Bank* v. *Title & Trust Co.*, 198 U.S. 280; *In re American Southern Pub. Co.*, 426 F. 2d 160 (C.A. 5); *Buss v. Long Island Storage Warehouse Co.*, 64 F. 2d 338 (C.A. 2). See generally the cases cited at 2 Collier, *supra*, para. 23.06[3], nn. 30 and 31.[10]

In this case, once the notice of levy and demand had been served upon Yorke, the general assignee, he held the proceeds not for the bankrupt or its general creditors but solely for the United States. Yorke held actual possession of the proceeds as custodian or bailee for the United States, which held constructive possession; following levy and demand the bankrupt retained no possessory interest, and consequently petitioner, whose rights derive from those of the bank-

[10] The Ninth Circuit in *In re United General Wood Products* purported to rely upon *Taubel, Etc., Co.* v. *Fox*, *supra*. But in that case this Court merely held that property in the hands of a non-adverse third person, who was not holding it as agent for any adverse claimant, was subject to summary turnover. That is not the situation here, for the assignee, Yorke, was holding the property for the United States, an adverse claimant.

rupt, acquired no such interest upon the subsequent bankruptcy. Accordingly, following levy and demand the proceeds were not subject to turnover in Yorke's hands.

This result serves the legitimate governmental interest in orderly tax collection. If the government could not rely upon its levy upon intangible property as conferring constructive possession for Bankruptcy Act purposes, it would be forced to engage in an unseemly scramble for actual possession of such property whenever the taxpayer was believed to be in precarious financial circumstances. That process might entail considerable disruption and inconvenience for third parties subject to levy, and for the taxpayer as well. Moreover, it is by no means clear how some forms of intangible property, such as, for example, accounts receivable and causes of action, could be quickly reduced to actual possession. Accordingly, for practical reasons of internal revenue collection, as well as for established reasons of bankruptcy law, the government should be entitled to rely upon a valid prebankruptcy levy as removing the intangible property subject to levy from the reach of summary turnover orders.

Petitioner offers two reasons why, in his view, this result should not follow. He contends, first, that Section 67c of the Bankruptcy Act requires that the United States establish actual possession of property that has been levied upon in order to avoid turnover of that property (Br. 20–22) and, second, that Sections 2a(21) and 70a(8) of the Bankruptcy Act require turnover of the assets held by a

general assignee without regard to any supervening government levy (Br. 23–24). For the reasons that we now discuss, neither of these contentions has merit.

B. IN PARTICULAR, PROPERTY HELD BY A GENERAL ASSIGNEE AS THE GOVERNMENT'S BAILEE IS NOT SUBJECT TO SUMMARY TURNOVER

1. The postponement provision of Section 67c of the Bankruptcy Act has no bearing upon the question of summary jurisdiction

Petitioner's reliance upon the postponement provision of Section 67c of the Bankruptcy Act is entirely misplaced.[11] That provision speaks not to the scope of the bankruptcy court's summary jurisdiction to order property turned over to the receiver, but only to the priority that is to be accorded tax liens on property that has already been determined to be within the court's jurisdiction. Section 67c(3) is a rule of bankruptcy administration that governs the distribution of the bankrupt estate, not a jurisdictional rule for determining whether property may be summarily ordered turned over to the estate in the first place. See 4 Collier, *supra*, para. 67.27[5].[12] That

[11] Section 67c(3) of the Bankruptcy Act, the "postponement" provision, subordinates "tax lien[s] on personal property not accompanied by possession" to claims for administrative expenses and wage claims under Section 64a(1) and (2).

[12] Indeed, the scope of the postponement provision is not even coterminous with the bankruptcy court's jurisdiction over property subject to liens. For example, although the bankruptcy court may summarily order turnover of real property in the bankrupt's possession, tax liens on such property are not postponed under Section 67c(3). But, in our view, the postponement provision is coterminous with the bankruptcy court's jurisdiction as to personal property subject to tax liens. Section 67c(3) postpones tax liens on personal property not within the

postponement provision is therefore irrelevant to this case.

The irrelevancy of Section 67c(3) here also is made manifest by the fact that that statute is addressed only to the question of the priority of tax liens, not to the effect of tax *levies*. If the government were asserting only its tax lien, this case would never have arisen.[13] A tax lien, standing alone, concededly would not have conferred upon the government constructive possession of the proceeds in the assignee's hands, and those proceeds would therefore have been subject to summary turnover.[14] See *Taubel, Etc., Co.* v. *Fox,*

government's "possession," which we understand to include both actual and constructive possession, and therefore by its terms applies only to personal property that is subject to summary turnover. We of course disagree with petitioner's claim (Br. 21–22) that this Court held, in *Coggin* v. *California Labor Dir.*, 336 U.S. 118, that Section 67c(3) refers only to actual and not to constructive possession. The Court there spoke in terms of actual possession merely because the facts showed such possession; no question of constructive possession was raised in that case. But the matter is in any event academic in the context of this case, for the scope of Section 67c(3) is not now before the Court.

[13] It may be noted, however, that the government's lien here satisfies the requirements of Section 67c(1) of the Bankruptcy Act, which renders invalid, as against the receiver or trustee, "every statutory lien which first becomes effective upon the insolvency of the debtor * * * [or] which is not perfected or enforceable at the date of bankruptcy against * * * bona fide purchaser[s] * * *." The government's lien under Section 6321 of the Code became effective as of the date of the assessment of taxes and it was perfected as against bona fide purchasers upon the filing of the notice of lien prior to bankruptcy.

[14] But even in those circumstances Section 67c(3) would be irrelevant to the threshold question of jurisdiction; that provision would come into play only upon the subsequent distribution of the bankrupt's estate.

supra. But the government's prebankruptcy levy here makes a crucial difference. By transferring the proceeds into the custody of the United States prior to bankruptcy, the levy removed those proceeds from the reach of the bankruptcy court's summary jurisdiction. Nothing in Section 67c is to the contrary.

2. Sections 2a(21) and 70a(8) of the Bankruptcy Act do not grant the bankruptcy court summary jurisdiction to order turnover of property held by an assignee as custodian for the United States

Section 2a(21) of the Bankruptcy Act grants bankruptcy courts jurisdiction to "[r]equire * * * assignees for the benefit of creditors * * * to deliver the property in their possession or under their control to the receiver * * *." This provision, which was enacted in 1938, "is simply declaratory of prior case law." 1 Collier, *supra,* para. 2.78[3]. That prior case law permitted summary turnover only where the assignee held possession as, in essence, the creditors' bailee (*In re McCrum,* 214 Fed. 207, 209 (C.A. 2)):

> The assignee under such conditions is not an adverse claimant, but merely the agent of the assignor for the distribution of the proceeds of the property, and as such agent his possession is that of the principal. He is a mere naked bailee for the creditors and has no right to retain the possession as against the trustee in bankruptcy.

In contrast, in this case the government's levy had the effect of terminating the agency relationship between the taxpayer and the assignee and the bailment relationship between the assignee and the taxpayer's creditors.

After the levy, Yorke held the proceeds here in question not as an assignee for the benefit of creditors but as the agent, custodian, or bailee of the United States (see p. 13, *supra*). Accordingly, the proceeds were not subject to summary turnover in his hands.

The purpose of Sections 2a(21) and 70a(8)[15] is merely to enable the receiver in bankruptcy to reach assets in the hands of the assignee in the same manner as if they were still in the hands of the bankrupt. In our view, this case would not be significantly different if there had never been a general assignment for the benefit of creditors: a levy upon intangible property in the hands of the taxpayer prior to bankruptcy would have had the effect of removing that property from the reach of the bankruptcy court's power to order summary turnover. Such a levy would, for the reasons discussed above (pp. 9–13, *supra*), have placed the intangible property in custody for the benefit of the United States, and, accordingly, after bankruptcy the United States could have asserted its constructive possession as against the bankrupt or the receiver in bankruptcy. The bankrupt in such circumstances would have held the property not in his own right but

[15] Section 70a(8) simply vests the receiver "with the title of the bankrupt as of the date of filing the petition * * * to * * * property held by an assignee for the benefit of creditors * * *." Although petitioner purports to rely upon this provision (Br. 24), he in fact shows (Br. 13–16) that the bankrupt itself had no title in the property following the assignment. See note 4, *supra*. In any event, whether or not the bankrupt held title under Illinois law prior to the levy, the prebankruptcy levy acted to vest title in the United States for all Bankruptcy Act purposes.

as the mere agent or bailee of the United States, and property so held is not subject to administration as part of the bankrupt's estate. See generally 4A Collier, *supra*, para. 70.18[4].

In short, Sections 2a(21) and 70a(8) were not intended to invalidate, and do not have the effect of invalidating, a prebankruptcy levy upon a general assignee. Those provisions simply grant the bankruptcy court summary power to reach property still held by a general assignee in his capacity as assignee: they do not affect the United States' right to a plenary adjudication of its right to retain property on which it levied prior to bankruptcy.

C. THE UNITED STATES' POSSESSORY INTEREST IN PROPERTY THAT IT HAS LEVIED UPON MAY BE CHALLENGED BY PETITIONER ONLY IN A PLENARY PROCEEDING FOLLOWING THE FILING OF A CLAIM FOR REFUND

The above discussion establishes that the United States, as an adverse claimant in constructive possession, is entitled to have its claims adjudicated in a plenary proceeding, and that the property it claims is not subject to summary turnover. The considerations we have adduced so far would apply generally to any adverse claimant. But two additional considerations, uniquely applicable to the United States, are also present here that further and conclusively demonstrate that the bankruptcy court lacked jurisdiction over petitioner's request for summary turnover: the United States' possessory interest in property that it has levied upon may not be terminated in a summary proceeding, and no proceeding of any kind,

whether summary or plenary, may be instituted, without first filing a claim for refund, to recover a tax alleged to have been erroneously collected.

1. The United States is entitled to an adjudication of its claims in a plenary proceeding

In *N.H. Fire Ins. Co.* v. *Scanlon, supra,* the United States had, as here, levied upon intangible property of a taxpayer (in that case, a debt) by serving notice of levy upon a third person (in that case, the debtor). An insurance company then brought a summary proceeding to quash the levy, on the ground that the debt was owed to the insurance company and not to the taxpayer. This Court held that the district court lacked summary jurisdiction to adjudicate the matter.

The Court first discussed the nature of summary proceedings (362 U.S. at 406–407; footnotes omitted):

> Summary trial of controversies over property and property rights is the exception in our method of administering justice. * * * Summary trials * * * may be conducted without formal pleadings, on short notice, without summons and complaints, generally on affidavits, and sometimes even *ex parte*. Such summary trials, it has been said, were practically unknown to the English common law and it may be added that they have had little acceptance in this country.

The Court then determined that summary proceedings were particularly inappropriate for the adjudication of the United States' rights to property that had

been levied upon in the course of internal revenue collection (362 U.S. at 407–408):

> * * * when a controversy like this is begun by peremptory seizure * * *, there is neither justification nor authority for carving out an exception to the uniform and regular civil procedure laid down by the Federal Rules, either for the benefit of the party from whom the property was seized or for any other claimant.
>
> * * * * *
>
> Property seized by a revenue officer for delinquent taxes is lawfully held by that officer in his administrative capacity and he has broad powers over such property.

By the same token, the summary procedures invoked by petitioner are inappropriate here. As in *N.H. Fire Ins.*, the government here seized and took custody of intangible property through service of notice of levy. Petitioner may adjudicate the lawfulness of that seizure through a plenary proceeding. See pp. 32–33, *infra*. But he is not entitled to a summary adjudication terminating the United States' possessory interest.[16]

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[16] This conclusion is reinforced, as this Court noted in *N.H. Fire Ins.*, by 28 U.S.C. 2463, which expressly provides that "property taken or detained under any revenue law of the United States shall not be repleviable * * *." That provision requires all actions challenging the government's interest in such seized property to be litigated in federal court, in order "to protect the custody of property seized by federal revenue officers against more or less summary state court action, * * * [and by] placing these cases exclusively within the jurisdiction of the federal courts, Congress did not indicate any intention to relax or alter the safeguards of plenary proceedings * * *." 362 U.S. at 409.

2. Petitioner's suit for summary turnover is barred by Section 7421 of the Code

At bottom, petitioner's suit for summary turnover of the proceeds held by the assignee is an effort to restrain the government from completing the collection of those proceeds. That effort is barred by the explicit command of Section 7421(a) of the Code that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person * * *."

The levy constitutes a significant step in the collection process.[17] That process is completed by voluntary surrender of the property subject to levy (Section 6332(a) of the Code), liquidation or sale of that property by the United States (Section 6335 of the Code), and application of the proceeds of the levy to the taxpayer's liability (Section 6342(a) of the Code). Petitioner by his suit attempts to prevent the assignee from surrendering to the United States the property that has been levied upon, which the assignee at present holds as the government's agent, and to require the assignee to turn over that property for administration in bankruptcy. It is therefore clear that petitioner's suit is brought "for the purpose of restraining the * * * collection of [a] tax."[18] Cf. *Bob Jones University* v. *Simon*, 416 U.S. 725; *Alexander* v. *"Americans United" Inc.*, 416 U.S. 752; *United States* v. *American Friends Service Committee*, No. 73-1791, decided October 29, 1974. Accordingly, petitioner's suit is barred by Section 7421 of the Code.

[17] Section 6331(a) of the Code provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same * * *, it shall be lawful for the Secretary * * * *to collect such tax* * * * *by levy* * * *" (emphasis added).

[18] In some circumstances, third persons may challenge an allegedly wrongful levy. See Section 7426 of the Code. But a receiver who asserts a claim on behalf of a bankrupt taxpayer does not fall within the scope of that provision. See H. Rep. No. 1884, 89th Cong., 2d Sess., pp. 27-29, 75-78; S. Rep. No. 1708, 89th Cong., 2d Sess., pp. 29-31.

A receiver in bankruptcy may not maintain a proceeding to restrain collection of property levied upon prior to bankruptcy, or to recover the property so collected, without first filing a claim for refund. See *United States* v. *Rochelle*, 363 F. 2d 225 (C.A. 5). Petitioner's remedy here is to await the completion of the collection process, and then, if he believes the tax to have been improperly assessed, to file a claim for refund on behalf of the bankrupt taxpayer and, if the refund is not granted, to bring a civil action for refund. See Section 7422 of the Code. That procedure, unlike petitioner's instant suit for summary turnover, would comport with this Court's observation in *Bob Jones University* v. *Simon, supra*, 416 U.S. at 736, that the principal purpose of Section 7421 of the Code is "the protection of the Government's need to assess and collect taxes as expeditiously as possible with a minimum of pre-enforcement judicial interference, 'and to require that the legal right to the disputed sums be determined in a suit for refund.' "

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General.
SCOTT P. CRAMPTON,
Assistant Attorney General.
KEITH A. JONES,
Assistant to the Solicitor General.
CROMBIE J. D. GARRETT,
KARL SCHMEIDLER,
Attorneys.

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In the

Supreme Court of the United States

OCTOBER TERM, 1974

CRAIG PHELPS, RECEIVER IN BANKRUPTCY IN THE MATTER OF CHICAGOLAND IDEEL CLEANERS, INC., BANKRUPT,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF OF THE PETITIONER

KEVIN J. GILLOGLY
Suite 865
One North LaSalle Street
Chicago, Illinois 60602
Attorney for Petitioner

Of Counsel:
DANIEL C. AHERN
DENNIS E. QUAID

The Scheffer Press, Inc.—(312) 263-6850

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REPLY BRIEF OF THE PETITIONER

ARGUMENT

I. THE UNITED STATES DOES NOT ENJOY A TAX LIEN ON THE BANKRUPT'S PROPERTY, OR THE PROCEEDS THEREOF, AND SERVICE OF THE NOTICE OF LEVY WAS INEFFECTIVE TO CONFER CONSTRUCTIVE POSSESSION ON THE UNITED STATES.

Upon the assignment by Chicagoland Ideel Cleaners, Inc., of its property to the assignee, the property interest of the corporation was terminated under the law of the State of Illinois. That fact, taken in conjunction with the intervention of the rights of *bona fide* purchasers from the assignee prior to the recordation of the Notice of Tax Lien or the service of the Notice of Levy upon the assignee, are the circumstances which prevent the United States from enjoying the rights of a lienholder in this case. This Court in *United States* v. *Bess*, 357 U.S. 51, 78 S.Ct. 1054, 2 L. Ed. 2d 1135 (1958) recognized and gave effect to the invalidity of a tax lien on the proceeds of property subject to a tax lien when the property interest of the taxpayer terminated, creating a fund for the benefit of third persons. The Respondent completely misinterprets the holding of *United States* v. *Bess*, *supra*. The tax lien therein did not follow and attach to the proceeds of the life insurance policy, being the face amount of the policy, for the reason that the taxpayer enjoyed no property interest in the proceeds of the policy as he had enjoyed in the policy prior to death. The statement of the Respondent (R. Br. 17) taken out of context of the full opinion only held that the cash surrender value of the policy was a fund accumulated for the benefit of the taxpayer and was subject

to his dominion prior to death. It did not mean as the Respondent would have the Court believe that the lien followed and attached to all the proceeds. In the case at bar, the Respondent seeks to assert a tax lien upon the proceeds of the assignee's sale, a fund in which the taxpayer had no property interest. Framed in the context of the *Bess* holding, the government wants the face amount of the policy. *Bess* held against this proposition.

The recordation of the Notice of Tax Lien and service of the Notice of Levy subsequent to the assignment and assignee's sale came too late to help the Respondent's position. The tax lien is invalid as to purchasers whose rights arise prior to the recordation of the Notice of Tax Lien, Section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6323(a), and when the requisite notice was recorded, there no longer existed any property or rights to property belonging to the taxpayer or subject to the lien. The purported levy was also ineffective for the reason that it operates only upon property of the taxpayer or subject to the lien, Section 6331(a) of the Internal Revenue Code of 1954, 26 U.S.C. 6331(a).

Contrary to the Respondent's assertion (R. Br. 17) that it would be deprived of its legitimate rights as a lienholder, any diminution of its rights resulted from a failure to diligently assert those rights. As the holder of an unperfected and secret tax lien, the Respondent failed to promptly assert and protect its rights from the intervention of third parties such as *bona fide* purchasers without knowledge or the initiation of a bankruptcy proceeding. Instead, the Respondent waited until the assignee had liquidated the property and then sought to reveal and assert its secret lien upon the proceeds, saving to itself the efforts and expenses of liquidation. The Respondent cannot sit upon its rights hoping to gain

an advantage and then complain that its rights have been jeopardized by its own delay. Further, the hypothetical situation propounded by the Respondent (R. Br. 17) lacks any conformance to the situation in this case. The assignee for the benefit of creditors was a trustee for creditors and not a mere donee. In his hands, the taxpayer had no property interest or power to recover his former property. The assignment created a new relationship between the assignee and creditors which cannot be duplicated by a transfer to a mere donee. The termination of the property interest of the taxpayer and creation of a special fund for creditors, acted to defeat the tax lien.

Throughout its argument, the Respondent labels the assignee as an agent or bailee of the taxpayer, or as a custodian of the government upon service of the Notice of Levy. Such arguments disparage the trust relationship existing between the assignee and the assignor's creditors as recognized by Illinois law. That relationship cannot be altered by the service of a Notice of Levy, even assuming it to be valid, upon property held by the assignee. Whatever the power of the Internal Revenue Code, changing valid state-created relationships is not encompassed therein.

In summary, the assignment terminated the property interest of the taxpayer in the assets and the sale by the assignee prior to perfection by the United States of its lien created a special fund unencumbered by the tax lien. The purported levy was ineffective, wanting any property of the taxpayer or subject to a lien upon which to operate. Under such circumstances, no possession, constructive or actual, could be obtained by the Respondent.

II. IN THE ABSENCE OF CONSTRUCTIVE POSSESSION BY THE UNITED STATES, THE BANKRUPTCY COURT OBTAINED SUMMARY JURISDICTION OF THE PROCEEDS OF THE ASSIGNEE'S SALE UPON INITIATION OF THE BANKRUPTCY PROCEEDING.

As a consequence of the failure of the Respondent's lien to attach to the proceeds of the assignee's sale, the Notice of Levy was ineffective, Section 6331(a). Pursuant to the provisions of that section of the Internal Revenue Code of 1954, a levy is completely dependent upon the validity of the lien or a property interest of the taxpayer. However, due to the delay of the Respondent, neither existed when the Notice of Levy was served. Consequently, the Respondent did not obtain constructive possession of the proceeds, nor does the Respondent have any right to rely upon its levy in order to give it constructive possession (R. Br. 24) under these circumstances. The intervention of rights of third parties such as the taxpayer's creditors under the assignment and that of the assignee's purchasers, alter this case from a simple levy upon the taxpayer's property or funds in the hands of mere custodians or debtors of the taxpayer. Here, the funds were now held for all creditors and the right of the taxpayer to recover the property on demand had terminated. Such circumstances distinguish and remove this case from that of a levy upon the taxpayer's bank, at which it maintains its account, or debtors who assert for themselves no claim to the property. In the latter situation, the Respondent would be correct; in the former which is before the Court, the proposition is erroneous.

The Respondent further asserts (R. Br. 24) that in the event it cannot rely upon a levy upon intangible personal property to confer constructive possession, the

government would be forced to engage in an "unseemly scramble for actual possession". What the Respondent describes as an unseemly scramble is merely a requirement that the United States perfect and assert its rights, before the intervention of third party rights. This is especially true when its rights arise from a secret lien which has the effect of inducing general creditors to continue to do business and extend credit to the taxpayer. It would be oppressive for the United States to create by administrative action its secret lien; allow the taxpayer to continue to operate on credit from general creditors; await a liquidation of the property by an assignee at no expense or effort to the government; and, then, to perfect its lien and simultaneously claim the proceeds. Yet, this is the position of the Respondent. In order to prevail, the United States must comply with its own statutes, Section 6323 of the Internal Revenue Code, by perfecting and giving notice of its lien and taking actual possession of the property before it passes to third parties. A contrary result would allow the United States to reap the benefits of its statutory rights without complying with the pre-conditions to those rights.

III. ASSUMING THAT THE UNITED STATES ENJOYED A VALID LIEN, THE TAX LIEN WAS POSTPONED TO COSTS OF ADMINSTRATION AND PRIORITY WAGE CLAIMS BY SECTION 67c(3) AS NOT BEING ACCOMPANIED BY POSSESSION.

The evolving Congressional concern over tax liens consuming such a great portion of bankruptcy estates that costs of administration and priority wage claims are not being satisfied has manifested itself in Section 67c(3) of the Bankruptcy Act, 11 U.S.C. 107c(3). This provision postpones tax liens to costs and priority wage claims when the lien is not accompanied by possession, which

is defined as actual possession. *Goggin* v. *Division of Labor Law Enforcement*, 336 U.S. 118, 69 S. Ct. 469, 93 L. Ed. 543 (1949). Even assuming that the Notice of Levy would confer constructive possession upon the United States, the lien would still be postponed to costs and priority wages. It might also be mentioned that the taxpayer's property consisted of tangible personal property subject to actual and physical seizure at the time of the assessments and thereafter. Rather than seize the property, the Respondent waited until it had been liquidated into cash by the assignee. Consequently, the United States should not be heard to complain concerning the difficulty of taking actual possession of intangible personal property.

The Respondent also asserts (R. Br. 26) that Section 67c(3) is inapplicable for the reason that the provision applies to liens but not levies. A levy is a device to enforce a lien and has no independent significance. The rights of the Respondent depend upon its lien and are subject to the effect of Section 67c(3) upon that lien.

IV. THE UNITED STATES IS NOT ENTITLED TO SPECIAL CONSIDERATION IN THIS PROCEEDING WHICH IS NOT AN ACTION TO RESTRAIN THE COLLECTION OF TAXES.

The Receiver's application sought to invoke the summary jurisdiction of the Bankruptcy Court over an assignee for the benefit of creditors. The United States chose to intervene in that action to assert its alleged tax lien, rather than rely under the penalty provisions of the Internal Revenue Code, Section 6332(c) and (d), 26 U.S.C. 6332(c) and (d). The United States' affirmative intervention distinguishes this case from *N.H. Fire Insurance Co.* v. *Scanlon*, 362 U.S. 404. It is also inconsistent that the Respondent relies (R. Br. 11) upon the summary

nature of the administrative proceedings which create its lien but object to the exercise of summary jurisdiction in a proceeding in which it intervened.

The claim that this proceeding sought to restrain the collection of taxes (R. Br. 32-33) fares no better. This proceeding concerns the alleged tax *lien*, not the underlying taxes. Upon bankruptcy, adequate measures have been provided to enable the United States to collect its taxes from the remaining assets of the bankrupt and a priority has been granted to those taxes. The Respondent is welcome to participate in the bankruptcy proceeding and seek a dividend based upon its claim.

V. THE POLICY OF THE BANKRUPTCY ACT SHOULD GUIDE THE COURT IN RESOLVING THIS CONTROVERSY.

The difficulty of this case is caused by the conflicting policies of the two federal statutes involved, the Bankruptcy Act and the Internal Revenue Code of 1954. The special consideration which the United States claims in this proceeding for the purpose of the expeditious collection of revenue is not usually countervailed as it is in this case. The question of priority of payment in collective insolvency proceedings is within the special province of the Bankruptcy Act. *United States* v. *Randall,* 401 U.S. 513, 91 S. Ct. 991, 29 L. Ed. 2d 273 (1971). Congress has created special powers and protections in the Internal Revenue Code to assure the collection of taxes, but when dealing with the subject of taxes and liens in bankruptcy proceedings, has acted to limit and restrict those broad powers and rights by postponing liens not accompanied by possession to costs and priority wages, Section 67c(3) of the Bankruptcy Act, 11 U.S.C. 107c(3), and providing for a partial discharge of taxes, Section 17a(1) of the Bankruptcy Act, 11 U.S.C. 35a(1). Therefore, the scope

and nature of a federal tax lien should for the purpose of this case be determined within the context of the Bankruptcy Act which contains a carefully considered set of priorities and treatment of taxes. Only the Bankruptcy Act considers both priorities and the treatment of taxes in collective insolvency proceedings. The Respondent should be strictly held to the statutory and judicially imposed limits of a federal tax lien and the pernicious theory advanced in *United States* v. *Eiland,* 223 F. 2d 118 (4th Cir. 1955) that a levy transfers ownership of intangible personal property without the prior perfection of the lien should not be utilized, as the Respondent has attempted to do, for the purpose of overriding the priorities established in the Bankruptcy Act. This is the basis of the ruling of the Court of Appeals for the Ninth Circuit in *In Re United General Wood Products Corp.,* 483 F. 2d 975 (9th Cir. 1973) which should be applied to the case before this Court.

CONCLUSION

The Petitioner respectfully urges this Honorable Court to reverse the judgment of the United States Court of Appeals for the Seventh Circuit and to uphold the order of the Bankruptcy Court.

Respectfully submitted,

KEVIN J. GILLOGLY
One North LaSalle Street
Chicago, Illinois 60602
Attorney for Petitioner

DANIEL C. AHERN
DENNIS E. QUAID
Of Counsel